

1 BEFORE THE WASHINGTON UTILITIES AND
2 TRANSPORTATION COMMISSION

3 In the Matter of the)
4 Application of)
5 QWEST CORPORATION)
6) Docket No. UT-021120
7) Volume VIII
8 Regarding the Sale and) Pages 676 to 880
9 Transfer of Qwest Dex to)
10 Dex Holdings, LLC, a)
11 non-affiliate,)
12 _____)

13 A hearing in the above matter was held on May
14 23, 2003, from 9:05 a.m to 5:10 p.m., at 1300 South
15 Evergreen Park Drive Southwest, Room 206, Olympia,
16 Washington, before Administrative Law Judge DENNIS MOSS
17 and Chairwoman MARILYN SHOWALTER and Commissioner
18 RICHARD HEMSTAD and Commissioner PATRICK J. OSHIE.

19 The parties were present as follows:

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1 PROCEEDINGS

2 JUDGE MOSS: We'll get to Mr. Mabey in a
3 minute, I've got some preliminaries to take care of
4 first. A couple of Bench requests. Bench Request
5 Number 3 is a request concerning the -- we talked a
6 couple of days ago about the Dex five year growth plan,
7 and this was we suspect or expect was presented to the
8 board of directors at some point in time. I don't know
9 if anybody here can confirm that or not.

10 MR. HARLOW: I don't think we can confirm or
11 deny that, Your Honor.

12 JUDGE MOSS: The request, however, is
13 presuming it was presented to the board of directors, we
14 would like the minutes.

15 MS. ANDERL: And, Your Honor, just so that we
16 are clear on Bench Requests 1 and 2, I have reviewed
17 those on the record because we have the transcript,
18 Bench Request 1 seemed to be limited just to the request
19 for the growth rates from the five year strategic plan,
20 but it occurred to me that perhaps what was really being
21 sought was the actual plan itself, and that's what we
22 were intending to provide.

23 JUDGE MOSS: And that's what my notes
24 indicate too, so the transcript might be unclear.

25 And then the Bench Request 2 was for the rate

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1 of return projections over the five year growth plan
2 period.

3 MS. ANDERL: Right.

4 JUDGE MOSS: And then so I have just given
5 you 3. And then 4 is also for board minutes assuming
6 they exist, and that would be in connection with the
7 presentation and approval of the second amended and
8 restated credit agreement.

9 Now, Mr. Trautman, you mentioned to me off
10 the record that Staff had a preliminary matter, so why
11 don't you go ahead and tell us what that is now, and
12 we'll see whether we want to take it up now or later.

13 MR. TRAUTMAN: Thank you, Your Honor. Yes,
14 we did have a matter we wanted to raise pertaining to
15 the cross-examination and any Commission questions for
16 Dr. Kalt, and particularly with regard to the
17 surrebuttal testimony on responding to Dr. Blackmon's
18 May 14th testimony and the conditions that were in that
19 testimony. And having read through that testimony now
20 that we were provided to -- provided with yesterday at
21 the hearings, Staff believes that it would be
22 appropriate and we would move to have all of the
23 surrebuttal testimony, and that would include that
24 that's to be filed by Qwest, filed and submitted before
25 Dr. Kalt is either crossed or asked questions by the

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1 Commission on that testimony. And to do otherwise
2 essentially is giving Qwest two bites of the apple.

3 I mean if we -- the testimony that's been
4 filed pertains to the conditions on the sale. These
5 conditions do not affect the buyer, they affect Qwest.
6 And, in fact, all of the testimony is couched in terms
7 of what the effect is on Qwest, and so Qwest and the
8 buyer essentially are the same party in this regard.

9 Furthermore, Dr. Kalt also has portions of
10 his testimony where he criticizes Dr. Blackmon for being
11 inconsistent with live testimony of individuals who have
12 testified after he filed his testimony, and so that's
13 exactly what's going to happen now. If Dr. Kalt is
14 crossed on the surrebuttal, then Qwest is going to have
15 the opportunity to listen to the -- to whatever cross
16 questions, whatever questions there are from the Bench,
17 and prepare its own testimony over the weekend, submit
18 it on Tuesday, and that testimony will not simply be
19 surrebuttal of Dr. Blackmon, that testimony will also be
20 in a sense a second additional round of surrebuttal that
21 will respond to the Commission questions that have
22 already been submitted.

23 We think Qwest would, by the same token,
24 would have problems, would have an objection if let's
25 say Dr. Selwyn had filed his testimony, gone on the

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1 stand, been asked questions, and then afterwards
2 Dr. Blackmon was entitled to file testimony after that,
3 taking those questions into account and filing another
4 round of testimony.

5 We would -- we have no objection to any
6 cross-examination of Dr. Kalt once the surrebuttal
7 testimony has all been filed, and we do have three days
8 next week set aside for cross-examination of that
9 testimony. And so in fundamental fairness to Staff, we
10 believe that the cross-examination and the questioning
11 of the surrebuttal portion of the testimony should be
12 deferred until all surrebuttal has been filed.

13 JUDGE MOSS: Mr. Harlow.

14 MR. HARLOW: Thank you, Your Honor. We
15 really largely have a timing issue here. I don't think
16 that there's a significant prejudice one way or the
17 other to any party, but it certainly is a big
18 inconvenience to the witness to come back again next
19 week. And we did resolve this a couple of days ago as a
20 procedural matter, and except for the question of the
21 inconsistent -- the testimony of Dr. Kalt, that
22 Dr. Blackmon's recommendation is inconsistent with
23 subsequent live testimony, there is nothing about the
24 procedural and the timing issues that Staff wouldn't
25 have been aware of when we discussed and worked out the

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1 schedule several days ago earlier in the week. So let
2 me just simply address the inconsistency.

3 I don't see how changing the timing of
4 Dr. Kalt's cross by Staff on his supplemental testimony
5 would be in any way -- would in any way have any bearing
6 on the question of that testimony that keyed off the
7 live witnesses earlier in this case. I think they can
8 be fully prepared to cross Dr. Kalt on that today.

9 JUDGE MOSS: Well, I think they're prepared
10 to cross Dr. Kalt. I think the concern is that one
11 result of that cross-examination and inquiry from the
12 Bench of Dr. Kalt will be to cue Qwest with respect to
13 the preparation of additional testimony by Mr. Reynolds
14 that is scheduled to be filed on Tuesday.

15 Do I have the argument right?

16 MR. TRAUTMAN: That is correct, Your Honor.

17 JUDGE MOSS: That is the concern they're
18 expressing.

19 MR. HARLOW: Well, I guess from a, yeah, I
20 mean that again is something that could have been
21 decided before, and Dr. Kalt might have gone back to
22 Boston and come back next week.

23 JUDGE MOSS: Well, it's before us now, so.

24 MR. HARLOW: But secondly, it kind of goes to
25 the issue of, I guess recharacterizing Staff's motion,

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1 it seems as though Qwest -- what they're saying is
2 Qwest's testimony might be more responsive to the issues
3 of concern to the Commissioners in the areas of interest
4 to the Commissioners, and I don't view that I guess as a
5 bad thing in terms of both the efficacy and the advisory
6 role of the Staff of the Commission in getting to the
7 right decision in this case.

8 CHAIRWOMAN SHOWALTER: I have a question.
9 Isn't it a matter of degree, and maybe it's an important
10 degree, but a matter of degree that every witness here
11 gets -- every later witness gets the benefit of
12 listening to the earlier witnesses, and on
13 cross-examination and questioning by the Bench anyway,
14 you know, Mr. Reynolds is at a greater advantage than
15 Mr. Kalt, but Dr. Blackmon may be at a greater advantage
16 than either of those. So the question is, well, what is
17 the distinction of the cross-examination type questions
18 and the filing of testimony. It strikes me that it is a
19 matter of degree insofar as the filing of the testimony
20 is in response to what has been filed. That is, there's
21 a narrowing effect, and there is in all of these
22 hearings over the course of the hearing generally the
23 Commissioners and the parties start to zero in on
24 certain issues that necessarily are informed by what has
25 preceded it.

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1 MR. TRAUTMAN: Well, Your Honor, I think it's
2 a difference in kind, not a difference in degree. I
3 mean it's one thing to say that when we have the
4 cross-examination round obviously there's an order,
5 somebody has to go first and somebody goes next, but
6 they're responding to questions from others. This is
7 entirely different in which case -- in which a party can
8 listen to the questions and take that into account and
9 now file additional testimony of their own. They can --
10 and they can perhaps reformulate, rehabilitate their own
11 issues based upon that testimony.

12 And in part, the motion also is based upon
13 the testimony itself, which we have just seen yesterday,
14 and it is again, although it's submitted by Dex
15 Holdings, it addresses the conditions that all affect
16 Qwest, and the testimony is written in that vein, and so
17 it's essentially if Dr. Reynolds is able to file a
18 second round of testimony, it's essentially a second
19 round of testimony on points that are relevant to Qwest.
20 So I think it's a difference in kind, not simply a
21 difference in degree.

22 And as far as the inconvenience if -- now
23 Dr. Kalt could be brought back next week, or for that
24 one portion of the testimony, if need be, it could be
25 done by phone. That would not -- that would be a rather

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1 minor inconvenience for the witness.

2 JUDGE MOSS: Commissioner Hemstad has a
3 question, I believe.

4 COMMISSIONER HEMSTAD: Well, I was just going
5 to make a comment, were we not taking pre-filed written
6 testimony but we were taking simply oral testimony as
7 was filed, the ability to respond to what's been
8 happening earlier of course is always available for the
9 last witnesses who are called as rebuttal witnesses, and
10 how is this different?

11 MR. TRAUTMAN: Well, that's partly the reason
12 that we often do it by written testimony, if possible,
13 to avoid that and to even out the playing field as best
14 possible. And ordinarily that's the way this would be
15 done. You would have simultaneous filings. There would
16 be no reason why you wouldn't have simultaneous filings.
17 And so the only reason that's really been proffered by
18 Dex Holdings is purported inconvenience of bringing him
19 and having him be questioned later. But if that could
20 be -- if that one piece could be accomplished say by
21 telephone --

22 CHAIRWOMAN SHOWALTER: I will tell you I have
23 a very strong preference against telephone
24 cross-examination.

25 MR. TRAUTMAN: And I am aware of that. I am

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1 aware of that, Your Honor. Then maybe he could be
2 recalled to the stand next week.

3 MR. HARLOW: Your Honor, just three very
4 quick points, if I may.

5 JUDGE MOSS: Yes, you may.

6 MR. HARLOW: First of all, it's not true that
7 the conditions only affect Qwest, because the buyer is
8 severely affected if the conditions this Commission
9 applies cause the transaction to fail to close. So I
10 think that should be fairly obvious.

11 Secondly, yes, we're disturbing the order.
12 The order has kind of been thrown out in this case, and
13 we agreed to do that earlier this week with full
14 knowledge of the potential concern that the Staff has.

15 And thirdly, let me remind the Commission
16 that the Staff has repeatedly said they have no cross
17 for this witness, and so it's only the Bench cross. And
18 so what the Staff is suggesting is that the Commission
19 has to -- the Commissioners have to try to split their
20 cross and in their minds divide it between the pre-filed
21 and the supplemental testimony, and that -- I just don't
22 think that's workable.

23 So I think we ought to just get on with it,
24 and the Commission I think will be more enlightened and
25 better able to reach a decision if they can simply cross

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1 Mr. Kalt once as well as it being a convenience for him
2 not to have to return.

3 JUDGE MOSS: Thank you, Mr. Harlow.

4 MR. TRAUTMAN: May I just clarify one point,
5 Your Honor. We said that we had no cross of his
6 original testimony. We have not seen the surrebuttal.
7 If we were given additional time, we may have questions
8 of him. We to this point if we were forced to go today,
9 we probably would not have sufficient time to develop
10 questions on the surrebuttal.

11 (Discussion on the Bench.)

12 JUDGE MOSS: All right, we have had our Bench
13 conference and are prepared to rule. The Bench's
14 decision on this is that the request that Staff is
15 making will be denied. We will go ahead with Dr. Kalt
16 today. The Bench may have some questions for Dr. Kalt
17 and feels that it has had an adequate opportunity to
18 prepare with respect to his late filed testimony that we
19 authorized in response to a prior motion.

20 If Staff believes that anything comes up in
21 Mr. Reynolds' supplemental testimony that arises from
22 the exchange today and that it needs a further
23 opportunity to have Dr. Blackmon testify with respect to
24 that, then we could make an opportunity for that next
25 week as appropriate in terms of some live direct or what

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1 have you.

2 So I feel as before when we discussed this
3 type of thing that we will get the record that we need,
4 and, of course, that is what we -- that is our goal here
5 is to have a full and complete record for a decision.
6 So I think we'll get there without prejudice to anyone.

7 MR. HARLOW: Thank you.

8 JUDGE MOSS: So if that takes care of our
9 preliminary matters, then we will ask Mr. Mabey to stand
10 and raise his right hand.

11

12 Whereupon,

13 RALPH R. MABEY,
14 having been first duly sworn, was called as a witness
15 herein and was examined and testified as follows:

16

17 D I R E C T E X A M I N A T I O N

18 BY MR. SHERR:

19 Q. Good morning, Mr. Mabey.

20 A. Good morning.

21 Q. Could you please state your name for the
22 record.

23 A. Ralph R. Mabey.

24 Q. And could you please state your employer and
25 your business address.

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1 A. My employer is LeBoeuf Lamb Greene & MacRae.
2 My principal office is 136 South Main Street, Salt Lake
3 City, Utah.

4 Q. Thank you. Do you have in front of you what
5 has been marked for this hearing as Exhibit 211, the
6 rebuttal testimony of Ralph R. Mabey?

7 A. Yes.

8 Q. Was that exhibit prepared by yourself or at
9 your direction?

10 A. Yes.

11 Q. And have you any corrections to that
12 testimony apart from those on pages 4, 5, and 6 that
13 were pre-filed?

14 A. No.

15 Q. Is Exhibit 211, your testimony, true and
16 correct to the best of your knowledge?

17 A. Yes, it is.

18 MR. SHERR: Your Honor, Qwest moves the
19 admission of Exhibit 211.

20 JUDGE MOSS: Hearing no objection, 211 will
21 be admitted as marked.

22 MR. SHERR: Mr. Mabey is available for
23 cross-examination.

24 JUDGE MOSS: Go ahead, Ms. Smith.

25 MS. SMITH: Thank you, Your Honor.

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C R O S S - E X A M I N A T I O N

3

BY MS. SMITH:

4

Q. Good morning, Mr. Mabey.

5

A. Good morning.

6

Q. I'm Shannon Smith, I'm with the Attorney

7

General's Office, I'm representing Commission Staff in

8

this matter. If I could refer you, please, to page 2 of

9

your testimony, which has been marked in this docket as

10

Exhibit 211, and at line 20 you begin a description of

11

the purpose of your testimony and the terms of your

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engagement by Qwest in this matter.

13

JUDGE MOSS: Slow down a little bit, please.

14

MS. SMITH: Thank you, Your Honor.

15

BY MS. SMITH:

16

Q. And I have a few more questions for you about

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the scope and nature of your testimony in this

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proceeding. And it's true, is it not, that you filed

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rebuttal testimony in this case and you did not file

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direct testimony on behalf of Qwest?

21

A. Yes.

22

Q. So your testimony is not in support of

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Qwest's direct case in support of its application; is

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that correct?

25

A. I would leave that to the legal decision, I

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1 suppose, of the Bench.

2 Q. I will withdraw that question then.

3 In Qwest's direct case, the company has
4 testified that essentially without the Dex sale
5 bankruptcy is likely. Are you testifying in any way as
6 to the likelihood that Qwest Communications
7 International, Inc., QCII, will seek bankruptcy
8 protection if the Dex sale is not allowed?

9 A. I have not been retained nor have I advised
10 Qwest with respect to bankruptcy matters, including with
11 respect to whether or not they may or should file
12 bankruptcy. However, my testimony does deal with the
13 pro's and con's of filing bankruptcy under the
14 circumstances as I understand them.

15 Q. Are you testifying as to the likelihood that
16 the Dex sale, if approved, would be sufficiently
17 positive to QCII's financial position that a bankruptcy
18 filing can be avoided?

19 A. No.

20 CHAIRWOMAN SHOWALTER: Ms. Smith, I'm just
21 going to, because you're reading your questions --

22 MS. SMITH: Yes, Your Honor.

23 CHAIRWOMAN SHOWALTER: -- it's really hard
24 for me to comprehend what the question is.

25 MS. SMITH: Yes, Your Honor.

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1 CHAIRWOMAN SHOWALTER: And then I'm not sure
2 what is being answered, so I just would ask you to slow
3 down.

4 MS. SMITH: I will slow down, and I will try
5 to be as clear as I possibly can with my questions for
6 the benefit of the Bench and the record.

7 BY MS. SMITH:

8 Q. Mr. Mabey, are you familiar with the terms of
9 the Rodney sale agreement?

10 A. I have sat through most of the hearings this
11 week and learned somewhat of the sale. In that -- only
12 in that respect am I familiar with the terms of the
13 Rodney sale.

14 Q. Are you familiar with the QC publishing
15 agreement with Dex?

16 A. I have again assimilated some understanding
17 of the publishing agreement as a result of attending the
18 hearing.

19 Q. Are you familiar with the non-competition
20 agreement between QC and Dex?

21 A. I am aware of it from the testimony I have
22 heard this week.

23 Q. Are you familiar with the amended and revised
24 credit agreement, known in this proceeding as the ARCA?

25 A. I have not been provided that agreement.

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1 There has been testimony concerning it and some mention
2 of it in Qwest's 10-K, I believe. I probably reviewed
3 some of that.

4 Q. At page 3, line 3, you state that you are not
5 acting nor have you been retained to act as bankruptcy
6 counsel for QCI or any of its subsidiaries. To your
7 knowledge, has QCII or any of its subsidiaries hired
8 bankruptcy counsel?

9 A. I don't know.

10 Q. Do you know whether QCII or any of its
11 subsidiaries have bankruptcy plans?

12 A. All I know is what I have heard at the --
13 which has been presented to the Commission during this
14 week.

15 Q. Have you discussed at all with the management
16 of QCII or any of its subsidiaries any sort of strategy
17 or planning for any bankruptcy filing?

18 A. No.

19 Q. So if that's the case then, Mr. Mabey, isn't
20 your testimony offered in this proceeding with respect
21 to the possible bankruptcy scenario of QCII or any of
22 its subsidiaries conjecture?

23 A. My testimony is based upon my knowledge of
24 the bankruptcy law and my knowledge of the facts which
25 have been presented to me in the documents that were

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1 produced to you.

2 Q. Now if you can turn to page 5 of your
3 testimony again, that's Exhibit 211, and beginning at
4 page 10 you -- or at line 10 of page 5, you discuss the
5 various priorities of creditor claims in a bankruptcy
6 proceeding. Are you sufficiently familiar with the
7 facts in Qwest's situation to say how the various
8 classes of creditors and stockholders would fare in the
9 event of a Qwest bankruptcy?

10 A. Well, with respect to the question -- insofar
11 as the question is how many cents on the dollar my
12 creditors receive, the answer is no. Insofar as the
13 question is what priorities of payment or treatment
14 would the bankruptcy law impose, the answer would be
15 yes.

16 Q. Are you able to answer that question without
17 having read the ARCA?

18 A. I believe I am in the fashion in which I
19 answered it.

20 Q. At page 7 of your testimony starting at about
21 line 9, you conclude your general review of the
22 bankruptcy process by describing how the company emerges
23 from bankruptcy protection. Do you see that place in
24 your testimony?

25 A. Yes.

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1 Q. At this point in the bankruptcy process, is
2 the company generally left in a position where it is a
3 viable company?

4 A. That depends upon the facts and
5 circumstances. Some plans of reorganization assume the
6 liquidation of the company. If the plan of
7 reorganization assumes the reorganization of the
8 company, then the bankruptcy judge must make a finding
9 that that -- that confirmation of the plan of
10 reorganization is not likely to result in liquidation or
11 further need for reorganization.

12 Is that sufficiently responsive? If not, I
13 could summarize by saying that if the plan of
14 reorganization which is confirmed is intended to
15 reorganize the company, then that is the expectation.
16 If it's intended to liquidate the company, then the
17 expectations are far different.

18 Q. Mr. Mabey, for the purposes of our
19 cross-examination here today, we are limiting our
20 cross-examination to any Chapter 11 reorganization
21 bankruptcy that the company might file, if that helps
22 you in terms of being responsive to the questions. And,
23 of course, we don't intend to limit your answer in any
24 way by that, but just so you understand going forward
25 that that's what we're assuming in our

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1 cross-examination.

2 A. Thank you.

3 JUDGE MOSS: And let me interject so that I'm
4 perfectly clear on this too, Judge Mabey. The Chapter
5 11 reorganization as I just understood your testimony
6 just now, one possible outcome under Chapter 11 could be
7 an orderly liquidation as opposed to shifting over into
8 a Chapter 7, is that --

9 THE WITNESS: That is correct.

10 JUDGE MOS: Okay, I just wasn't clear on that
11 point.

12 THE WITNESS: And indeed the plan of
13 reorganization itself may provide for liquidation if the
14 creditors vote in favor and say, you know, we think
15 that's -- we think that's what we would like to see
16 happen, then it could go forward.

17 JUDGE MOSS: Okay, thank you.

18 BY MS. SMITH:

19 Q. Would the reorganization plan leave the
20 company with any debt at all?

21 A. Typically the reorganization plan
22 restructures the debt and reduces the debt but tries to
23 restructure the debt into industry norms.

24 Q. So would the desire be then to restructure
25 the debt but leave the company in a position that it

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1 would still be able to meet its debt obligations?

2 A. Yes, that's correct, to look at the debt to
3 equity ratios that other strong and competitive
4 companies have typically and reduce the debt so that
5 it's within those ratios.

6 Q. And in your experience, is it common for a
7 large company to emerge from a bankruptcy only to find
8 itself again in bankruptcy in a short period of time,
9 such as a matter of months?

10 A. It is not common. It is not unprecedented.

11 Q. Are you familiar with the bankruptcy of
12 WorldCom and its intended reorganization as MCI?

13 A. Somewhat. I follow it as a bankruptcy
14 lawyer. Except for a personal involvement at the
15 beginning of the case, I have not been personally
16 involved.

17 Q. Is it your understanding that the reorganized
18 company emerging from the WorldCom bankruptcy, the MCI
19 company, is expected to be a viable company?

20 A. It's my understanding that the MCI portion of
21 the company is expected to be a viable company.

22 Q. And one of the things that your company --
23 that your testimony doesn't cover is the role of the
24 board of directors in the whole bankruptcy procedure and
25 bankruptcy process. Could you please explain to the

0701

1 Commission where the fiduciary duty of the directors
2 lies outside of bankruptcy and how that duty changes
3 when a company becomes insolvent or approaches
4 insolvency?

5 A. Well, in general terms, the directors owe a
6 duty to the shareholders typically. Courts in Delaware
7 particularly have written decisions respecting the
8 vicinity of bankruptcy or insolvency to the effect, as I
9 recall and I haven't reviewed them recently, that the
10 responsibilities of the board begin to shift during when
11 in this vicinity. After insolvency occurs or bankruptcy
12 occurs, typically one assumes that the shareholders owe
13 a fiduciary duty or the -- strike that. The directors
14 owe a fiduciary duty to the bankruptcy estate as a
15 whole, and often that is -- that is particularly a duty
16 to maximize the value of the estate typically for the
17 benefit of creditors. But the cases aren't really clear
18 cut on these duties. I think it's best said that the
19 directors owe a fiduciary duty to the bankruptcy estate
20 to maximize its value after bankruptcy is filed.

21 Q. Do you know whether the QCII board of
22 directors has now determined that it owes a fiduciary
23 duty to the company's creditors?

24 A. I do not.

25 Q. If I can turn you back a page to page 6

0702

1 beginning at about line 9 where you discuss the ability
2 of a company in bankruptcy to reject burdensome
3 executory contracts; do you see that testimony?

4 A. Yes.

5 Q. Now that the Dexter transaction has closed,
6 if Qwest Corporation, the regulated company, were to
7 seek bankruptcy protection, might the regulated company
8 be able to reject the publishing agreement and the
9 non-competition agreement that currently are in place
10 between QC, the regulated company, and Dex Media Inc.?

11 A. The only familiarity I have with that
12 agreement is what I have heard in the courtroom, and so
13 I don't know. It strikes me that that's a possibility.

14 Q. If I could turn you ahead a few pages to page
15 9 of your testimony, and beginning at line 6 and
16 carrying through to line 9, you discuss:

17 An element of the currently proposed
18 sale of Dex is two long-term agreements
19 by which QC would agree to designate the
20 buyer of Dex as its official directory
21 publisher, and QC would agree not to
22 publish a competing directory.

23 Do you see that testimony?

24 A. Yes.

25 Q. What agreements are you talking about in your

0703

1 testimony at page 9?

2 A. I believe the agreements that have been
3 mentioned this week as the publishing agreement and the
4 non-competition agreement.

5 Q. And you have testified during
6 cross-examination that you're not familiar with those
7 agreements or that your familiarity with those
8 agreements stems from sitting here in the hearing room;
9 is that correct?

10 A. Yes, that's correct, but I also received
11 information from the 10-K obviously, now that I see that
12 I did at least during the time of drafting this
13 testimony was aware of the existence of those
14 agreements.

15 Q. And when you drafted your testimony, what was
16 your understanding of the terms of those agreements?

17 A. That QC would agree to designate the buyer of
18 Dex as its official directory publisher and would agree
19 not to publish a competing directory.

20 Q. In your experience, is it common in a
21 bankruptcy case for a company to emerge from bankruptcy
22 and operate under long -- operate under a long-term
23 non-competition agreement?

24 A. Yes, I think that's entirely possible.
25 Naturally bankruptcies vary so much and are so fact

0704

1 specific that it depends on the business of the company
2 and what makes the most economic and business sense.

3 Q. Are you familiar with any real world examples
4 of companies coming out of bankruptcy and continuing
5 business under a long-term non-competition agreement?

6 A. Well, many companies have restructured as
7 franchisees and have been bound by those franchise
8 agreements going forward, which often include
9 non-competition clauses, I believe. High tech companies
10 that come out of bankruptcy are reorganized, typically
11 honor their license agreements insofar as they're
12 important to their business, and those agreements may
13 include non-competition clauses.

14 Q. Now given your awareness of the Dexter and
15 Rodney purchase agreements, are you aware of any
16 provisions in either of those agreements that would
17 attempt to prevent Qwest from declaring bankruptcy after
18 closing of the purchase?

19 A. I have heard no discussion of that, and I'm
20 not aware of such a provision.

21 Q. Would you agree with the proposition that the
22 regulated company, QC, when viewed separately from the
23 parent company, QCII, would be a more valuable business
24 entity if it retained the right to publish directories
25 on its own or sell that right to another entity?

0705

1 A. I don't know.

2 Q. Well, assume that then as a hypothetical. If
3 you were to assume that scenario that the regulated
4 company, QC, would be in bankruptcy, do you believe that
5 it would be a more valuable business entity if it
6 retained the right to publish a directory or to sell
7 that directory in its own right?

8 MR. SHERR: Your Honor, if I can interpose an
9 objection. I think, I'm a little confused, because I
10 think Ms. Smith asked him to assume that as a
11 hypothetical and then asked him the same question again.

12 JUDGE MOSS: She asked him to assume that
13 Qwest Corporation, the regulated entity, is in
14 bankruptcy and what his opinion is as to whether it's a
15 more valuable entity if it retains the right to publish
16 a directory or sell such a business.

17 MR. SHERR: Okay, I apologize, I must have
18 misunderstood the question.

19 JUDGE MOSS: Did I get the question right?

20 MS. SMITH: That's correct, Your Honor.

21 JUDGE MOSS: Okay, the witness I think has
22 the question in mind.

23 THE WITNESS: Yes, thank you.

24 A. It seems to me that the answer is purely a
25 business decision, an economic decision that would

0706

1 depend upon the facts, interrelationship with other
2 companies, previous agreements, future opportunities,
3 and I just am not comfortable guessing with respect to
4 the business or economic decisions.

5 MS. SMITH: Your Honor, may we take just one
6 moment, please.

7 JUDGE MOSS: Sure.

8 MS. SMITH: Thank you, Your Honor.

9 BY MS. SMITH:

10 Q. Mr. Mabey, if you recall the earlier
11 hypothetical scenario that I had given you, I'm asking
12 you the same situation, but for purposes of the
13 hypothetical, please assume that the directory
14 publishing business is a very lucrative business, and
15 with that assumption, do you think that the creditors of
16 Qwest Corporation, the regulated company, are better off
17 in a bankruptcy scenario if the company retains the
18 lucrative directory publishing business?

19 A. Or rejects the contract?

20 Q. Or rejects the contract or has the business
21 itself either to use to generate revenue or to sell the
22 business itself for its own business purposes apart from
23 the business purposes of QCII.

24 A. I see. In order to answer this question,
25 it's important for me to state that when a contract is

0707

1 rejected, there's an innocent party, and there's the
2 debtor that rejects the contract. The innocent party
3 has a damage claim equal to the amount of the party's
4 damages. Therefore, if QC or Qwest Corporation were to
5 reject this contract, there would arise immediately
6 damages in favor of the innocent contracting party.
7 Those damages could be very substantial. Therefore, the
8 creditors of Qwest Corporation would need to consider
9 the -- would need to weigh their decision by weighing
10 the economic benefit against the economic detriment of
11 the damages. And if the damages equaled or exceeded the
12 gain, and assuming Qwest Corporation is solvent,
13 creditors I would think would be deterred from seeking
14 to reject or seeking to have the company reject the
15 contract.

16 Q. Well, then let's assume that there is no
17 danger of a contractual breach and there's no danger of
18 liability, and we're just talking about Qwest
19 Corporation itself facing bankruptcy. And would you
20 agree that the presence of a lucrative directory
21 publishing business that's owned by QC would be
22 something of value to the creditors in the QC
23 bankruptcy?

24 A. Well, putting aside the rejection damage
25 issues, it would seem to me that if you tell me there's

0708

1 value, I think creditors like value.

2 And this may not be responsive, if you would
3 like to ask me the question again, I may have lost the
4 thread.

5 Q. I think I will move on, Mr. Mabey, thank you.

6 Is it your understanding that some but not
7 all of the creditors of QCII have a lien on the common
8 stock of Qwest Corporation?

9 A. Yes.

10 Q. In a bankruptcy scenario, would those
11 creditors have an interest in protecting the value of
12 Qwest Corporation as an asset that is distinct from
13 QCII?

14 A. It depends, of course, on how those creditors
15 are going to be treated in the bankruptcy. If they're
16 going to be paid off in the bankruptcy, then there
17 wouldn't be concern. If they're going to retain their
18 lien on the stock of QC, then they would be concerned
19 that QC's value be maintained.

20 Q. So might the ARCA lenders then object to a
21 bankruptcy plan that reduces the value of Qwest
22 Corporation as a going business entity?

23 A. You know, many things can happen in
24 bankruptcy, and that is a possibility, but it's highly
25 unlikely here based upon what I have heard. I have

0709

1 heard that the creditors entered into the ARCA, if I
2 have that correct, with the expectation that there would
3 be a sale of Dex. And so it would seem to me in
4 bankruptcy that they would be eager to have that sale
5 completed.

6 Q. If you can turn ahead, please, to page 14 of
7 your testimony, and at line 1, and this is a carryover
8 from line 13, at line 1 you refer to Enron's 2,500
9 direct and indirect subsidiaries. Are you with me?

10 A. Yes.

11 Q. How many of those Enron companies filed for
12 bankruptcy in December of 2001?

13 A. That is a good question. I can't recall the
14 number. I will guess 100.

15 Q. Does 14 sound a little more like it?

16 A. It sounds a lot less than 100, and I think 14
17 may sound more like it.

18 Q. Do you know if any of those companies,
19 whether they be 14 or 100, own pipelines or energy
20 utilities?

21 A. Not to my knowledge.

22 Q. A couple pages ahead at page 16, starting at
23 line 13 and carrying through to line 15, you testify
24 that the Commission Staff has concluded that PGE has
25 benefited from Enron's bankruptcy. Do you see that

0710

1 testimony?

2 A. Yes.

3 Q. Could you provide a specific reference to
4 Staff's testimony that makes this claim?

5 A. If I may see the testimony which I have
6 reviewed, I would look through it and seek to comply.

7 MS. SMITH: Counsel, could you -- Your Honor,
8 could counsel provide the witness with a copy of the
9 testimony he's referring to?

10 JUDGE MOSS: Ms. Anderl is busily doing that
11 even as we ask.

12 THE WITNESS: I may have some underlined
13 copies in --

14 JUDGE MOSS: I think Ms. Anderl will be able
15 to furnish you with copies.

16 MR. SHERR: Your Honor --

17 JUDGE MOSS: Why don't we, while we're having
18 a pause looking for this, why don't we take our morning
19 recess and give ourselves 15 minutes, and we can provide
20 the witness with that during the break.

21 (Recess taken.)

22 JUDGE MOSS: Now we had a question pending to
23 the witness, which was a request that he point in
24 Staff's testimony to with respect to his testimony at
25 page 16 of Exhibit 211.

0711

1 THE WITNESS: May I answer?

2 JUDGE MOSS: Yes, go ahead, please.

3 CHAIRWOMAN SHOWALTER: But I would say, if
4 you're going to answer, can you begin with the exhibit
5 number and then pause.

6 A. With respect to the testimony of Kathleen M.
7 Folsom, which is --

8 JUDGE MOSS: That's pre-identified as Exhibit
9 431.

10 A. -- Exhibit 431, there are a number of
11 statements on pages 7, well, actually beginning on page
12 5, beginning on page 4 through 7, 8, 9, in which
13 Ms. Folsom says that the credit rating of Portland
14 General even though in bankruptcy is higher than QC and
15 also notes, I believe, that Portland General has been
16 ring fenced since filing bankruptcy, that there's no
17 incentive to put Portland General into bankruptcy.

18 And in the direct testimony of Dr.
19 Blackmon --

20 MR. SHERR: Your Honor, that's Exhibit 37.

21 JUDGE MOSS: Thank you.

22 A. On page 13, he says, line 15, he says:

23 Indeed, QC might even be better off with
24 its parent in bankruptcy.

25 I concluded from these pages of testimony

0712

1 attempting to point out the health of Portland General
2 in bankruptcy as compared to the relative lack of health
3 of QC or its related companies outside of bankruptcy and
4 Dr. Blackmon's statement that QC might be better off in
5 bankruptcy, I felt it was reasonable to conclude from
6 that that Staff believed that Portland General has
7 benefited from Enron's bankruptcy, at least insofar as
8 the ring fencing goes, which occurred after Enron's
9 bankruptcy.

10 Q. If I can direct your attention, please, to
11 page 17 of your testimony, and at the end of line 7 and
12 continuing through to line 9, you state that it's highly
13 likely in a bankruptcy Dex would be sold and the
14 proceeds of the sale distributed to creditors. Are you
15 there?

16 A. Yes.

17 Q. Now there are many references in your
18 testimony to what may happen and what might happen and
19 if one thing happens what might flow from that, but here
20 you say it's highly likely that in bankruptcy Dex would
21 be sold. What is your opinion about the likelihood that
22 in a QCII bankruptcy QC, the regulated company, would be
23 sold?

24 A. Well, again, that's very much a business
25 decision. I was able to use the words highly likely

0713

1 with respect to the sale of Dex based upon the
2 information I received that the sale of Dex was integral
3 to the plan for creditors. With respect to the sale of
4 QC, that would be a business decision. I will simply
5 note that as I understand it, QC is completely
6 integrated and interrelated with the related QC
7 companies, QCI, QCS, and perhaps some other letters of
8 the alphabet, and it seems to me quite unlikely that
9 there would be a sale.

10 In the Enron situation, Portland General was
11 already on the auction block before bankruptcy was
12 filed. Clearly Enron saw its reorganization as being
13 without Portland General, whereas it's -- it appears to
14 me to be far from the case here where Qwest Corporation
15 is completely integrated into the operations and the
16 future of QCI, so I don't think it would be likely based
17 upon the information which I have.

18 Q. Is it your testimony that it is highly likely
19 that Dex and QC would be sold to separate independent
20 owners?

21 A. I don't believe I have testified with respect
22 to that. I don't believe QC would be sold, and I
23 believe that Dex would be sold to the present proposed
24 purchasers in order to avoid huge damages, and I believe
25 that's the burden of my testimony on that point.

0714

1 Q. What damages would you have in mind if the
2 Dexter sale were to close after the bankruptcy were
3 filed?

4 A. As I understand it, there is an agreement to
5 purchase Dexter, and a sale in bankruptcy presumably
6 would violate that agreement. Now I don't claim to have
7 all the facts in front of me, but if that's the case,
8 then there could be some damages.

9 Q. And what --

10 A. Future damages.

11 Q. I apologize for stepping on your toes.

12 A. Excuse me, I started up again, and I'm sorry.

13 Q. If the bankruptcy were to occur before the
14 Rodney sale were to close, what damages would you be
15 referring to?

16 A. Well, if it occurs before the sale, then I
17 think an observer would fully expect that the Dex sale
18 would go forward to the present proposed purchasers. If
19 it did not, then the contract for the purchase
20 presumably would be breached.

21 Q. Have you considered the possibility that in a
22 bankruptcy the creditors would decide to keep QC, the
23 regulated company, and Dex together?

24 A. It's -- no, I haven't, because the creditor
25 arrangements, as I understand them, anticipate the sale

0715

1 of Dex and because Dex is not now an asset of QC. And
2 therefore, keeping it together is not a bankruptcy
3 concept that is clear to me.

4 Q. Starting at page 18, line 14, of your
5 testimony and continuing through just about the
6 conclusion of your testimony, you summarize the risks of
7 bankruptcy. Would you say as a general matter that it's
8 better for everyone involved to avoid bankruptcy filings
9 whenever possible?

10 A. I don't want to adversely affect my
11 livelihood, and so -- and apart from that, obviously
12 bankruptcy is an excellent solution in the proper
13 circumstances. However, bankruptcies are unpredictable,
14 and things can go a little different from what you
15 expected. Therefore, it is a very sobering decision and
16 one that must be taken advisedly. There are examples,
17 many examples though, of course, where bankruptcy has
18 been a very effective -- has resulted in a very
19 effective reorganization of the business.

20 Q. I have a hypothetical scenario that I would
21 like you to assume. Assume that Qwest were to win a
22 very large arbitration award against another
23 telecommunications company with which Qwest does
24 business. Now also assume that if Qwest were to seek to
25 collect that arbitration award, the liable company would

0716

1 be forced to seek bankruptcy protection. In that
2 circumstance, my question is, is it reasonable to expect
3 Qwest to forgive that liability so as to avoid the
4 bankruptcy filing of the other telecommunications
5 company?

6 A. That depends. Bankruptcy is designed to
7 distribute assets equally among creditors, and so if
8 this company's claim is one that's very large and might
9 sink the other company, it might well be best advised to
10 proceed outside of bankruptcy through state enforcement
11 procedures, knowing that if bankruptcy is filed all the
12 other creditors might participate more actively in the
13 pie. In other words, outside of bankruptcy, our debt
14 collection structure is snatch and grab. Whoever is the
15 strongest creditor, who can get there first, may get the
16 best recovery. In bankruptcy it's share and share alike
17 according to statutory priorities. So a creditor needs
18 to make the judgment as to, well, would we try to
19 collect outside of bankruptcy, or would we mitigate our
20 collections in order to keep the company outside of
21 bankruptcy and maybe make due with less, or do we go
22 after it hammer and tongue and we don't care if they
23 file bankruptcy, we'll just file our claim there and
24 stand in line with the other creditors. There's a
25 spectrum of issues that would need to be addressed in

0717

1 order to decide.

2 Q. And, Mr. Mabey, before we began the
3 cross-examination today, I had your counsel provide you
4 with a page from PGE's 10-K filing. Do you have that
5 before you?

6 A. Yes, I have a document that says at the
7 bottom page 101.

8 Q. And did you review PGE's 10-K in preparation
9 of your testimony today or when you filed it?

10 A. At some point I have looked at it, yes.

11 Q. And the PGE 10-K is included on the CD-ROM
12 that was provided in response to a data request that
13 asked Qwest to provide all documents that the company
14 provided to you that you used in preparing your
15 testimony; is that true?

16 A. Yes, I believe it is.

17 Q. Rather than have the whole 100 plus page
18 document in front of you, would you accept that this
19 page 101 that you have is an excerpt from PGE's 10-K
20 that's on the CD-ROM?

21 A. Yes, I would be happy to.

22 Q. And at the bottom of the page you see in bold
23 the subject matter, merger receivable. Are you familiar
24 with the merger receivable that's discussed on this
25 page?

0718

1 A. Not other than this discussion, but I did
2 read these two paragraphs after receiving the page.

3 Q. Do those two paragraphs refer to any
4 difficulty that PGE might have in enforcing the credit
5 mechanism referred there?

6 A. This document says that Enron owed and was
7 required to make monthly payments to Portland General
8 and that after bankruptcy it stopped making those
9 payments and has not paid them. It evidences to me that
10 a revenue credit would have been a better antibankruptcy
11 strategy.

12 Q. So if the Commission in this case, and again
13 I'm asking you to assume that the Commission here were
14 to decide as a condition of approval of the Dex
15 transaction on revenue credit to customers in the
16 future, do you have any suggestions on how the credit
17 mechanism could be structured to reduce any
18 vulnerability to bankruptcy of either QC, the regulated
19 company, or QCII, the parent company?

20 A. Yes.

21 Q. I was going to ask you to please describe
22 that.

23 A. Thank you. The first point which I make in
24 response to the question is that it would be important
25 from the Commission's standpoint and from QC's

0719

1 standpoint to have the transaction, the sale of Dex,
2 occur outside of bankruptcy. If QCI decides to file
3 bankruptcy because the terms are unacceptable, then the
4 bankruptcy court will have very expansive jurisdiction
5 over the sale of Dex. Indeed, 28 USC Section 1334 gives
6 the bankruptcy court exclusive jurisdiction over the
7 assets of a debtor wherever located in the world. So I
8 preface my answer by saying that any conditions imposed
9 in order to be effective need to be acceptable so that
10 the sale of Dex does not occur in bankruptcy.

11 Now if then the parties agree and the sale of
12 Dex occurs outside of bankruptcy and there's a revenue
13 credit over some period of years, I believe this is a
14 very secure mechanism for the Commission and for QC.
15 Because the sale would have occurred outside of
16 bankruptcy so that the bankruptcy court didn't exercise
17 its broad jurisdiction over it, and a revenue credit is
18 not an agreement requiring QCI to make payments to QC.
19 And, of course, bankruptcy is all about restructuring
20 debts, and so if you avoid the obligation of making
21 payments, you're better off.

22 And finally, the Commission has its highest
23 strength in rate orders from a federal bankruptcy
24 standpoint. And insofar as the revenue credit is seen
25 as part and parcel of a rate order and the sale of Qwest

0720

1 is consensual so that it occurs outside of bankruptcy
2 and not in bankruptcy, it seems to me that there is
3 substantial protection.

4 In summary, if QCI files bankruptcy and the
5 bankruptcy court takes jurisdiction over the sale of
6 Dex, it will have its broadest jurisdiction and will
7 trump I believe most other actions. If it is agreed
8 that the sale can occur without filing bankruptcy and QC
9 is the beneficiary of a revenue credit, which really
10 doesn't require a transfer of funds from QCI to QC, then
11 that revenue credit I believe would be seen as part of
12 the rate making process and would not be disturbed in
13 the unlikely event that QCI still had to file
14 bankruptcy. On the other hand, if this Commission
15 imposed restrictions and QCI said, we will file
16 bankruptcy instead and effect the sale in bankruptcy,
17 then I believe those restrictions would be vulnerable.

18 Q. One last question for you, Mr. Mabey, are you
19 familiar with the use of hypothetical capital structures
20 for rate making purposes?

21 A. Somewhat.

22 Q. And with that familiarity, I would ask you to
23 assume that a utility company has 100% debt in its
24 capital structure, but for rate making purposes the
25 Commission imputes a more reasonable capital structure

0721

1 of 40% debt and 60% equity. Can you make that
2 assumption, or just do you understand that assumption I
3 guess?

4 A. I think I'm over my head.

5 MS. SMITH: I think that's all we have then,
6 thank you.

7 THE WITNESS: Thank you.

8 JUDGE MOSS: All right, then we'll turn to
9 the Bench for questions.

10 CHAIRWOMAN SHOWALTER: Thank you.

11

12 E X A M I N A T I O N

13 BY CHAIRWOMAN SHOWALTER:

14 Q. I think I will begin by going backwards just
15 in a follow up just on the very last exchange or second
16 to the last exchange you had in which I think you were
17 saying that a credit was further from the reach of a
18 bankruptcy court than, and I'm not sure what the than
19 was, contractual obligations?

20 A. Yes, than an agreement, for instance,
21 requiring QCI to make payments to QC.

22 Q. That's okay. My question is though, you
23 still have to make ends meet, so that if there were a
24 contractual agreement or some kind of definite agreement
25 that the bankruptcy court could get at, maybe that would

0722

1 prove then an illusory benefit to the rate payers. But
2 if there is a credit and we order it, then that's the
3 rate, but there's not enough money to make ends meet, is
4 it any better just because the bankruptcy court hasn't
5 gotten to it?

6 A. I think it is. Let me just say that in the
7 Pacific Gas & Electric case, PG&E has proposed to
8 transfer its assets out of the reach of the California
9 Commission. And the opinion of the bankruptcy judge in
10 discussing the federal preemption issues says that if
11 the bankrupt -- says in effect, as I read it, if the
12 bankruptcy decides to transfer these assets and the
13 commission says, well, we're going to impute some value
14 to them and in effect siphon the money off for another
15 direction, I will issue an injunction. That is evident,
16 that's a strong argument to me that if Dex ends up, the
17 sale of Dex ends up in bankruptcy, then the bankruptcy
18 court may well interfere with a revenue credit.

19 But if the sale occurs before bankruptcy so
20 that it wasn't under the jurisdiction of the bankruptcy
21 court, and particularly if it occurs under an agreement
22 such that there's no incentive to put QCI into
23 bankruptcy, and the court enters an order, a revenue
24 credit, then it seems to me because the bankruptcy code
25 defers to some extent to rate orders that this rate

0723

1 order would be protected. A rate order connected to a
2 sale by -- of an asset in bankruptcy is at risk. A rate
3 order connected to a sale that occurred before
4 bankruptcy and particularly consensually I think has the
5 strongest protection.

6 Now, Chairwoman Showalter, I think you
7 posited the possibility, well, there's not enough money
8 to go around, we had this sale outside of bankruptcy, we
9 entered a rate order involving a revenue credit, and now
10 bankruptcy is filed, are we at risk. I think the risk
11 would be very, very small, because the sale occurred,
12 the parties agreed to the distribution of the assets,
13 the revenue credit was agreed to, and the only way the
14 court might attack that I think would be to try to set
15 aside the entire sale of Dex and resell it, which is
16 highly unlikely to occur.

17 Q. And I guess when I said what if there's not
18 enough money to go around, I didn't really mean to be
19 asking what would the bankruptcy judge do about it. I
20 mean where does the money come from? If there's not
21 enough money to afford the credit, then at some point
22 the regulated company is going to come to us and say we
23 can't afford it, or there will be tension, I presume,
24 between QC and the new -- and QCII.

25 A. Well, let --

0724

1 Q. I'm just saying as a matter of cash, if you
2 use the proceeds of the sale to pay off debt, that
3 improves in the first -- in the short run the status of
4 the debt, but it also has removed the cash that used to
5 be presumed to support that imputation. So if it's not
6 there, it's got to come from somewhere. Now perhaps it
7 would just come out of the profits of the company if
8 there were enough profit to be had.

9 A. I will explain my understanding, and then you
10 can correct me, because this is not entirely a
11 bankruptcy issue and will be more in your expertise.
12 The way I picture a revenue credit in this instance
13 would be that ordinarily the owner of Qwest Corporation
14 would be entitled to receive profits from Qwest
15 Corporation. If, however, a revenue credit is
16 instituted, there is in effect an assumption that the
17 owner of QC already has received the benefit of certain
18 revenue. And therefore, when it comes time for the
19 Commission to determine the rates for the rate payers of
20 QC, it can say, we don't need to worry about this
21 particular return to the owners, because we have assumed
22 a certain credit constituting part of that return.

23 And in the -- on the outside chance that my
24 understanding is halfway correct, then it seems to me
25 that there's no -- not going to be any disturbance with

0725

1 respect to this revenue credit, because it's simply a
2 question of whether QC is solvent. If QC is solvent and
3 has the money to reduce the rate payers' rates based
4 upon a new rate case that figures in this revenue
5 credit, then the inquiry need go no further, and it does
6 not implicate the owner of QC, and there's no money that
7 moves from the owner of QC to QC. There's just less
8 money going from QC to its owner.

9 Q. So isn't then the question becomes how large
10 is this credit compared to the profits that QC otherwise
11 would collect?

12 A. I think that might be right, and I would
13 eagerly defer to your expertise on the subject. My
14 expertise would simply say that if the credit is too
15 large or is non-consensual, then there's a risk of
16 bankruptcy and effecting the sale of Dex in bankruptcy,
17 which would reduce the Commission's authority in my view
18 substantially.

19 Q. Also and then following up on a point that we
20 were on about five minutes ago, could you turn to page 9
21 of your testimony, and I'm looking at Footnote 15.

22 A. Yes.

23 Q. In which the bankruptcy court frowns on
24 attempts to circumvent its own orders. My question is,
25 we are sitting here today having a big recorded

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1 conversation about what's the best thing to do to stay
2 out of the way of a bankruptcy judge. Is our motivation
3 today in a prebankruptcy arrangement something that a
4 bankruptcy court would take into account?

5 A. It seems to me that your motivation is
6 entirely proper, that the bankruptcy court in this -- as
7 cited in this footnote is concerned with a circumstance
8 where the court has a jurisdiction over the assets and
9 is deciding where they're going to go and where and who
10 gets the money, which is what bankruptcy decides, who
11 gets the money. And then if the Commission acts knowing
12 the bankruptcy court, that it's inconsistent with the
13 bankruptcy court's decision, the bankruptcy court would
14 take this action apparently.

15 I don't believe that if this court says, this
16 Commission says we're dealing with a proposed sale, it's
17 presented to us, we're not in bankruptcy court, we're
18 approving a settlement or taking whatever action we
19 wanted to take and consistent with parties' agreement,
20 this is what we're going to do, I just feel that that's
21 very, very safe in a bankruptcy court, particularly if
22 it's consensual.

23 In the Cajun Electric case, I was appointed
24 by the Justice Department to represent the utility as
25 the bankruptcy trustee. It was an unusual situation.

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1 We have been to the Fourth Circuit, the Fifth Circuit
2 four times, and the Louisiana Public Utilities
3 Commission, Public Service Commission, has been a party
4 in those appeals. And in the Pacific Gas & Electric
5 case, the Public Service Commission argued in the Ninth
6 Circuit here two weeks ago. If we let the sale get into
7 bankruptcy, that's where the money is spent and the
8 controversy over does federal law or state law, you
9 know, what can you do, what can the bankruptcy court do.
10 If the transactions occur before bankruptcy and are
11 final and finalized, then there's no, you know,
12 overreaching, everybody is treated fairly, it seems to
13 me there's the greatest protection. And I don't think
14 it's a good idea to have a debt owing but rather to do
15 it by a revenue credit.

16 Q. All right. Could you turn to Exhibit 213.

17 A. Yes.

18 Q. I read this article, and I just have a number
19 of questions, maybe not precisely about the article, but
20 they're prompted by my reading of it. First, does QCI
21 have a right to bring QC into bankruptcy?

22 A. Yes, I would think so in this sense, that the
23 board of directors of QC could make the determination to
24 put QC into bankruptcy, and as I understand it, the
25 owner of QC has, you know, great influence on the board

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1 of directors, so I would think so, yes. There's no
2 requirement, of course, of insolvency.

3 Q. So in the first instance, it is the board of
4 directors that decides to declare bankruptcy for any
5 number of its subsidiaries or company as a whole?

6 A. Yes, or the board of each of those entities,
7 unless creditors involuntarily put somebody into
8 bankruptcy, and as happened with NRG. That involuntary
9 bankruptcy, however, was later dismissed and wouldn't be
10 an issue for QC, because QC's creditors are being paid.

11 Q. And as I read your testimony and this
12 article, it pointed out that the ring fencing was done
13 prior to or the essential ring fencing was done prior to
14 Enron declaring bankruptcy, perhaps partly because it
15 was going to sell it anyway. But I think you should
16 disregard the introduction to that sentence, to that
17 question.

18 My question is, is there anything at this
19 point today that this Commission can do that would help
20 QCI to avoid or decide not to bring QC into a bankruptcy
21 should QCI itself want to be bankrupt, or do you think
22 it's just more likely that because the two are entwined
23 that they would go together.

24 A. First of all, the ring fencing in Enron
25 performed by Enron occurred after Enron filed

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1 bankruptcy.

2 Q. All right, thank you for that correction.

3 A. It seems to me the greatest incentive that
4 QCI has to place QC in bankruptcy would be to effect the
5 Dex sale and the entry into -- of the publishing and
6 non-competition agreements that are part of it. If the
7 sale has occurred and those contracts have already been
8 entered into, it strikes me that QCI may have no
9 incentive to put QC into bankruptcy. And one reason
10 that PGE, and by this I mean Portland General Electric,
11 that is not Pacific Gas & Electric Company, one reason
12 PGE has the confidence of Standard and Poor's is because
13 it has some ring fencing protection, and S&P has
14 concluded that Enron has no economic incentive to put
15 PGE into bankruptcy. So I think removing the incentive
16 is the best protection for keeping QC out of bankruptcy.

17 Q. And I want to make sure we're on the same
18 wavelength in terms of the question. I'm positing that
19 the sale goes through and maybe three or four years from
20 now at some point QCI is in trouble, and at that point
21 it is deciding what to do about its future and also
22 QC's. Was that your understanding when you answered
23 that question?

24 A. I think I was looking more to the
25 immediate --

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1 Q. Right.

2 A. -- issue of the incentive to get these
3 publishing and non-compete agreements entered into --

4 Q. Well, maybe --

5 A. -- and the sale completed.

6 Q. -- you could answer the question I just
7 posed. What I'm thinking, what I'm trying to compare in
8 my mind is we -- is the scenario where we do approve the
9 sale, it goes through, time goes on, and then there is
10 some kind of financial trouble in QCI as a whole, and
11 comparing that to the scenario where we don't approve
12 the sale and we're just the state of Washington and
13 looking at that whole scenario, but right now I'm asking
14 you about the first scenario.

15 A. Well, I come back first of all to the -- my
16 belief that if you eliminate the present incentive, then
17 there doesn't appear to be much incentive to put QC into
18 bankruptcy. Now three years from now, it seemed -- I
19 guess it's speculation in a sense, but perhaps I could
20 answer it this way.

21 Pacific Gas & Electric Company, a utility,
22 filed bankruptcy. It had the incentive to remove its
23 generation and transmission assets from the jurisdiction
24 of the public service, public utilities commission. I
25 don't think you see that in a QC, which is much more of

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1 an integrated, you know, it's a telecom and it's far
2 different, so that incentive doesn't seem to be there.

3 El Paso Electric and Public Service of New
4 Hampshire filed bankruptcy because the commissions
5 refused to give them rate increases they needed to pay
6 their debts. Both of them had nuclear power plants and
7 needed a lot of money. I don't see that incentive for
8 QC, because QC is healthy, and this Commission is
9 maintaining that health. So I'm unable to speculate on
10 what incentive there might be.

11 With respect to the possibility of ring
12 fencing, that strikes me as a difficult proposition for
13 QC, because it's spread around 14 jurisdictions. And
14 the ring fencing in Enron was a vote of the shareholders
15 of PGE to create a new class of stock and make it -- and
16 issue one share and put it in the hands of somebody that
17 Standard & Poor's had confidence in, and so in that way
18 it was protected from bankruptcy. It's very hard to do
19 with an entity that's spread across many jurisdictions
20 and not necessarily foolproof since Pacific Gas &
21 Electric has announced it intends to put one of its ring
22 fenced subsidiaries into bankruptcy, so nothing's for
23 sure.

24 But it just seems that now having made a very
25 roundabout answer, or maybe not roundabout, but a

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1 searching answer, it's hard to see what incentives there
2 would be to put QC into bankruptcy three years from now.

3 Q. So if we wanted to approve the sale but we
4 were concerned about the future and we wanted to approve
5 the sale subject to the condition that the company, the
6 regulated company, be ring fenced in some way, you
7 would, what I take your answer to be is, there's really
8 not much of a way, but you don't think we should worry
9 about that too much because of these incentives. Is
10 that right?

11 A. I think -- I think that is correct, and if
12 fertile minds could find some way, then it would be
13 important -- then one might face the risk of an earlier
14 bankruptcy to prevent that.

15 Q. Okay. I know I have, oh, here it is. You
16 said that in a reorganization the bankruptcy judge must
17 find that the reorganization plan is not likely to go
18 bankrupt again. I'm using those words. But for how
19 long into the future is that finding or that prediction?

20 A. The section is Section 1129 of Title 11 of
21 the U.S. Code, and there are many subsections here. I
22 just need a moment, if I may have it. I have found it,
23 1129(a)(11), this is the finding the court would make,
24 and it's Section 1129(a)(11).

25 Confirmation of the plan is not likely

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1 to be followed by the liquidation or the
2 need for further financial
3 reorganization of the debtor or any
4 successor to the debtor under the plan
5 unless such liquidation or
6 reorganization is proposed in the plan.

7 A circumstance that Judge Moss asked about.

8 Q. So there's no time, I mean so in other words
9 not likely to have to be liquidated next month, but not
10 making any prediction for next year?

11 A. I think the court in my experience looks at
12 the facts and says, is there going to be another, is
13 there going to be a need for another reorganization, I
14 find no. And that's the finding, I believe.

15 Q. You also talked about, used the phrase reject
16 the contract, and I just wasn't certain what you mean.
17 It sounded like a term of art, and what were you
18 describing?

19 A. I was describing a procedure which is set out
20 in Section 365 of Title 11 of the U.S. Code, which is
21 the bankruptcy code. And it allows companies in
22 bankruptcy, which are called debtors or debtors in
23 possession, to breach or reject onerous contracts and
24 leases. And so we can see some of the fallout of this
25 in United Airlines, although there is a special

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1 provision for labor contracts. We can see it in K-Mart
2 where K-Mart rejected leases with dozens or hundreds --
3 for dozens or hundreds of stores in order to
4 restructure. And the court allows the rejection of
5 these executory contracts or leases based upon primarily
6 the business judgment of the company.

7 Is that of some assistance?

8 CHAIRWOMAN SHOWALTER: Yes, and I think
9 because I wasn't certain what was meant there, I
10 probably didn't follow the answer, but I will go back
11 and read it now that I understand what is meant, thanks.

12

13 E X A M I N A T I O N

14 BY COMMISSIONER HEMSTAD:

15 Q. Reviewing or just pursuing some of your
16 answers on the cross-examination, first, the scenario of
17 ultimate liquidation involving the utility here is
18 entirely unlikely; isn't that true?

19 A. Yes, I think so, involving Qwest Corporation.

20 Q. Yes.

21 A. Yes, I would think so.

22 Q. This is a viable ongoing operation of an
23 essential public service and healthy, and so liquidating
24 it is not a plausible scenario?

25 A. I would accept your view on that,

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1 Commissioner. It makes eminent sense from what I know.
2 Selling possibly the utility is something that might,
3 you know, might happen.

4 Q. Sure. And selling the utility at least with
5 respect to consumers would have no measurable effect?

6 A. I certainly defer to you on that,
7 Commissioner, but I believe selling the utility in this
8 instance is most likely to mean selling it as an entity.

9 Q. Another, well, QCII as I understand it, I
10 assume you do also, is a highly leveraged company with a
11 lot of debt assets, and that's why it's in trouble?

12 A. I believe that's correct.

13 Q. So you have a lot of secure creditors who in
14 a bankruptcy proceeding would at least say one outcome
15 would be that in a bankruptcy proceeding and if QC were
16 pulled into that, the primary asset of QCII with value
17 is the utility; isn't that true?

18 A. I believe that's correct.

19 Q. So a scenario would be for the creditors to
20 become the shareholders of a restructured company that
21 is essentially the utility?

22 A. Yes, that is a possible scenario.

23 Q. And in that scenario, the shareholders, the
24 current shareholders would be wiped out, but the
25 creditors would end up owning the company?

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1 A. In that, yes, in that hypothetical, that
2 could be the case, or it's possible that the creditors
3 and shareholders might share ownership depending upon
4 the values that there were.

5 Q. Chairwoman Showalter really covered much of
6 what I would have pursued.

7 A. Commissioner, may I just add to my answer
8 that if creditors take some ownership or all ownership
9 of QC, then their debt would be reduced pro tanto.

10 Q. I understand, in other words --

11 A. In order to make -- I'm sorry, I stepped on
12 your question.

13 Q. No, I stepped on your answer.

14 In effect, the debt would be either wiped out
15 or very substantially reduced in order, as bankruptcy is
16 intended to do, to make a viable company come out of it,
17 and the company essentially, well, the assets of any
18 real value here are, one, QC, the utility, and two, Dex?

19 A. Yes. There is a further factor, and that is
20 that QCI would have the exclusive right to file a plan
21 of reorganization at least to begin with, and this right
22 is often extended. So QCII might prefer to say, we're
23 going to restructure the debt, we're going to reduce it
24 in certain ways, we're going to change the terms, and
25 we're going to keep ownership of QC. And if that plan

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1 met the statutory requirements, then it could be
2 confirmed. It is possible for creditors to have the
3 right to file the plan themselves and then make their
4 decision. But in the large cases, that isn't seen
5 frequently.

6 Q. And all of that depends on the degree of
7 leverage of the company. Counsel began to offer you the
8 hypothetical of a company with 100% debt in bankruptcy.
9 Well, those creditors who would in effect, if there was
10 any viability there at all, would become the owners of
11 the assets in the form of selling it or becoming the
12 shareholders?

13 A. If I understand a company with 100% debt,
14 that's just another way of saying it's insolvent?

15 Q. That's right.

16 A. If it's insolvent, then the priority of
17 payment would kick in, and creditors do get paid before
18 shareholders unless the creditors agree to let the
19 shareholders retain some value.

20 Q. And they would do that only if they saw it to
21 be in their interest to do that. In other words,
22 they're not going to do it out of the goodness of their
23 hearts, they're going to do it as a rational choice as
24 to how to maximize their interest?

25 A. Yes, that's true, although shareholders often

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1 are left with some part of the company, not out of the
2 goodness of the creditors' heart even if the company is
3 insolvent, but to avoid litigation in bankruptcy.

4 Q. Which is part of the rationalizing of the
5 best way to proceed of course.

6 A. Yes.

7 Q. Chairwoman Showalter was pursuing with you
8 the relative value of the proposed revenue credit as
9 against some kind of a contractual benefit, and I
10 believe it was your response that the revenue credit
11 would be the most secure from restructuring or
12 intervention, or it would be more secure than some kind
13 of contractual arrangements on behalf of the ultimate
14 rate payers or the beneficiaries. But doesn't it follow
15 if in the process of the bankruptcy court ultimately
16 seeking to have a viable utility and taking into account
17 the priority claims of the secured creditors, why
18 couldn't it direct that either a lesser amount or no
19 such revenue credits could be applied in the future by
20 this Commission as a way to make a viable operation?

21 A. Assuming, as I did in my earlier answers,
22 that the sale of Dex occurs outside of bankruptcy, and
23 the revenue credit is part and parcel of that agreement,
24 then I see the revenue credit as in the nature of a rate
25 order. And when the bankruptcy code was amended in

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1 1978, it removed the power of a commission such as this
2 to approve a plan of reorganization, but it retained the
3 power of the commission to approve rate. And I think
4 that this Commission's strength lies in a rate order
5 that is made at the time a sale occurs, provided the
6 sale occurs outside of bankruptcy. And it just seems to
7 me that is its greatest strength.

8 If a contract is entered into so that QCI
9 becomes a debtor, owes money, that's a sort of thing
10 that a bankruptcy -- that might be adjusted in
11 bankruptcy. Or if the Dex sale occurs in bankruptcy,
12 then as this Footnote 15 suggests, the bankruptcy court
13 might reach out to attack an imputation if it were felt
14 to be inconsistent with the terms of the sale.

15 Q. Without getting into any details then, just
16 so the record is clear, the Pacific Gas & Electric case
17 is on appeal at the present time?

18 A. Yes, it is. And to be more specific, the
19 bankruptcy court's decision, which is on page 15, was
20 reversed by the district court, although not with
21 respect to this quoted language. Then the district
22 court was appealed to the court of appeals, and the two
23 sides argue this. One side argues that Section 1123 of
24 the bankruptcy code expressly preempts inconsistent
25 state law such as state law that would restrict the sale

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1 of a utility. The other side argues there's no express
2 preemption, but there may be implied preemption, and
3 we'll just need to look at it on a fact-by-fact
4 case-by-case basis. The case has been argued, the Ninth
5 Circuit has said it would rule promptly. I don't know
6 what that means.

7 Q. And just so the record is clear, I believe
8 this Commission either has joined that appeal or through
9 our national organization is participating in that
10 proceeding.

11 And again, this is really a detail on the
12 ring fencing issue as I understand it, while Enron may
13 have proceeded after bankruptcy in part on this, a
14 measurable amount of ring fencing were done by the
15 Oregon Commission at the time of the purchase of PGE by
16 Enron as a condition of that purchase.

17 A. Yes. Of course, ring fencing doesn't have
18 any definition or any formal definition, but the Oregon
19 Commission on the sale of that asset, as I understand
20 it, imposed restrictions, that asset being Portland
21 General Electric, and that sale occurred in 1997, as I
22 recall.

23 Q. Just one ultimate final I suppose I will call
24 it a quibble on page 18 at line 14 when you say,
25 "anything can happen in bankruptcy". I assume you would

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1 agree that that's a bit extreme, isn't it? I mean
2 people hire you to advise them as to what are the likely
3 scenarios and advantages and disadvantages of filing
4 bankruptcy. I mean it is not a coin flip, it involves
5 predictions as to what is likely to occur?

6 A. Very, very true. I do advise people that
7 anything can happen in bankruptcy and then go on to give
8 specific advice, but I confess error, anything is a
9 little broad.

10 Q. Well, put it this way, it's not unlike when
11 any litigation is commenced, there is uncertainty to the
12 outcome, but there are predictions of likelihood of a
13 responsible court?

14 A. Yes, that's correct, and I intend by this
15 advice with my clients to just make sure they understand
16 that while you have control of your company now, if you
17 put it in bankruptcy, you might lose control.

18 COMMISSIONER HEMSTAD: That's all I have,
19 thank you.

20 THE WITNESS: Thank you.

21

22 E X A M I N A T I O N

23 BY COMMISSIONER OSHIE:

24 Q. Good morning, Judge Mabey.

25 A. Good morning.

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1 Q. I guess I will, you know, as Commissioner
2 Hemstad has noted, I think the waterfront has pretty
3 well been covered, but there is a couple of clarifying
4 questions in one area I would like to pursue. I guess
5 my question is really in a general sense and not
6 necessarily pertaining to bankruptcy, but I believe that
7 you may have some expertise in this area. But in your
8 opinion, do the or does the board of directors of Qwest
9 Corporation owe a fiduciary duty to its shareholder,
10 which is its parent company, QCII, to assist it when it
11 is faced with financial difficulties?

12 A. I believe that the board of QC owes a
13 fiduciary duty to its shareholder. I'm not sure what
14 that fiduciary duty would require with respect to
15 assisting the shareholder, because typically one looks
16 at the duty as a little narrower. And so I understand
17 your question, and I'm not sure that I really know the
18 answer. It seems to me fiduciary duty might be defined
19 narrower.

20 Q. I guess would it be fair to say that the I
21 guess the conflict between -- in this circumstance would
22 be a duty to the shareholder, which is QCII, and also
23 the board's duty to manage the company in a way that is
24 most beneficial to its operations and, of course, to the
25 rate payers in the state of Washington?

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1 A. I think that one must bear in mind that
2 there, as I understand it from the 10-K, QC does a lot
3 of business services and goods with related companies,
4 and bankruptcy might -- it might be helpful to put these
5 entities into bankruptcy at the same time to sort out
6 those duties. Also I believe that a board would take
7 account of the fact that bankruptcy isn't permanent,
8 particularly if there has been a pre-negotiated or
9 preplanned bankruptcy. And so the board would weigh the
10 short run and the long-run effect of bankruptcy on QC in
11 deciding what to do.

12 Q. Let me kind of take a little bit of a
13 different direction here, but I want to follow up on
14 some questions that were asked by both the Chair and
15 Commissioner Hemstad on ring fencing, and would you
16 agree that one of the elements, if you will, of a ring
17 fence is a separation of the management of the two
18 companies, if you will, the affiliate and the parent?
19 And so let's put it in these circumstances, that to
20 effectively ring fence QC, QC would have to be
21 separately managed from QCII?

22 A. I believe, Commissioner, that ring fencing
23 can be defined in any way. In the instance of Portland
24 General, Portland General had a separate management when
25 it was purchased by Enron. In the instance of PG&E's

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1 national energy group, which may now enter bankruptcy
2 even though ring fenced according to the announcement of
3 Glen, who chairs Pacific Gas & Electric Corporation,
4 which is the parent, I'm not sure that management is
5 separate.

6 Q. So it would be your testimony that wouldn't
7 be a necessary element of the creation of a ring fence?

8 A. Not every ring fence would have separate
9 management.

10 Q. Do you think that the most effective ring
11 fence would be to spin off in this circumstance Qwest
12 Corporation from QCII if the objective was to protect
13 QCII, its resources, and the rate payers?

14 A. I don't know. I think it's beyond my ken to
15 advise long term what the best economic future -- how to
16 find the best economic future for any of these entities.
17 I'm just not sufficiently imbued with their
18 circumstances.

19 Q. Do you think that if QC were spun off from
20 its parent corporation that a bankruptcy court would try
21 to pull that transaction back if QCII followed the
22 spinoff with a Chapter 11 filing?

23 A. If the -- it's possible if the QCII
24 creditors, for instance, were dissatisfied with the
25 spinoff, particularly the creditors that had a lien on

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1 the stock of QC, but also the other creditors who look
2 to the value of QC to support the value of QCII. So one
3 risk would be that the transaction were seen to be
4 unbalanced or unfair or for less than reasonably
5 equivalent of value. If the spinoff were ordered but
6 not effected, then one might assume that QCII would file
7 bankruptcy and QC before it became effective just based
8 upon the background I have soaked up, but also subject
9 to specific fact. Other than those eventualities,
10 nothing else comes to mind that would be helpful in
11 answering the question.

12 Q. In the practice of the -- in the field of
13 bankruptcy, and I guess perhaps as your prior position
14 as a bankruptcy court judge, how, what effect does the
15 passage of time have upon the hypothetical that I
16 presented, which is the spinoff of QC and then a filing
17 by QCII of a Chapter 11 bankruptcy petition? If it
18 were, for example, three years or two years post
19 spinoff, will the court take that into consideration?

20 A. It could.

21 Q. Or --

22 A. Forgive me. It could have an important
23 effect. Transactions that are made for less than
24 reasonably equivalent value can be set aside as
25 so-called fraudulent conveyances under federal

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1 bankruptcy law and also under state law, and there's a
2 statute of limitations with respect to those. So
3 taking, for instance, the transfer of Qwest Dex, which I
4 heard occurred in -- 19 years ago or so, if one were
5 going to reach back to try to set that aside, one would
6 be faced with the statute of limitations of fraudulent
7 conveyances, which to my knowledge none of them reach
8 past six years. The specific bankruptcy statute of
9 limitations for fraudulent transfers is one year, but
10 the debtor in possession or trustee may use the state
11 statute of limitations under certain circumstances,
12 which might allow a reachback of four years, three
13 years, six years depending upon the state's fraudulent
14 transfer law.

15 Q. I want to follow up on a question that was
16 asked by I believe the Chair and also a question that
17 was asked by counsel for Staff. On the authority of the
18 court to, the bankruptcy court, to avoid, if you will,
19 executory contracts, and I believe that specifically the
20 Staff counsel raised the issue of the publishing
21 agreement between QC and the buyer in this transaction
22 which we're faced with today and the non-compete
23 agreement, and your answer contained in part a caution,
24 if you will, that if there was a breach of the agreement
25 or these executory agreements between QC and the buyer,

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1 even in the event of a bankruptcy that there would be
2 you would have to weigh if you were making a judgment as
3 to whether to breach the imposition of damages as a
4 result of the breach. Now my question is, and I guess
5 it's just a clarification, is that the -- any damages
6 would not be dischargeable in bankruptcy?

7 A. No, the damages could be discharged in
8 bankruptcy after available assets were expended to pay
9 them.

10 Q. Unless confirmed by the debtor? Or would you
11 think the court would allow a confirmation of the
12 executory contract?

13 A. Well, may I just run through a hypothetical.
14 If, for instance, bankruptcy were filed and the
15 executory contract to purchase Dex were breached or the
16 executory contract which is the publishing agreement or
17 the non-competition clause, then presumably the
18 purchaser of Dex would have damages, and those damages
19 presumably would be quite large. This is a very large
20 transaction, so the damages might be quite large. If
21 the company against whom the damages are assessed, say
22 Qwest Corporation is found to be liable for these
23 damages and is in bankruptcy, then since Qwest
24 Corporation is solvent, the damages are going to have to
25 be paid 100 cents on the dollar. If the damages rested

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1 at another level in another company that was not
2 solvent, then after damages had been paid up to the
3 available assets, presumably the remainder on the plan
4 of reorganization would be forgiven, as it were.

5 Q. Just one more question and just to really
6 clarify in the event that there is a filing by QCII or
7 QC of a Chapter 11, at what point does the bankruptcy
8 court jurisdiction terminate?

9 A. It usually is said to terminate when the case
10 is closed. After the plan of reorganization is
11 confirmed, typically the bankruptcy court retains
12 jurisdiction to enforce the confirmation, enforce the
13 plan, and typically the case is not closed until the
14 plan has been performed. After the case is closed, it
15 is possible to reopen the case if a dispute arises over
16 the plan of reorganization and people seek to get back
17 in front of the bankruptcy court to enforce its order or
18 the like. But I think the answer is that if the case is
19 closed, the jurisdiction ordinarily would be seen to
20 have ended.

21 Q. After the plan of reorganization has been
22 filed and I guess through the enforcement period, do the
23 -- does the -- would the managers of the -- of the
24 petitioner be required to bring unusual transactions to
25 the bankruptcy court for approval?

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1 A. After the plan has been confirmed and become
2 effective, then the managers are no longer under the
3 thumb of the bankruptcy court, and they can just operate
4 under the plan of reorganization, which is seen as a
5 contract, and so they just comply with the terms of the
6 contract. The court still retains jurisdiction to
7 interpret the plan or enforce it for a period of time,
8 but management is free to manage the company outside of
9 bankruptcy.

10 COMMISSIONER OSHIE: Okay, thank you, no
11 further questions.

12 THE WITNESS: Thank you.

13 JUDGE MOSS: Ms. Smith, did you have any
14 brief follow-up to the Bench's questions before we turn
15 to Mr. Sherr for redirect?

16 MS. SMITH: Yes, Your Honor, and it will be
17 brief.

18

19 R E C R O S S - E X A M I N A T I O N

20 BY MS. SMITH:

21 Q. Mr. Mabey, in the scenario where QCI is in
22 bankruptcy and the creditors are trying to get the
23 maximum value for Qwest Corporation, would the price
24 that a sale of Qwest Corporation would command be less,
25 all else being equal, with the revenue credit in effect

0750

1 than without it?

2 A. I think just accepting the terms of the
3 hypothetical that that's not a bankruptcy question at
4 all. It's just a question of, you know, you need to ask
5 an investment banker or anybody else selling a company.

6 MS. SMITH: That's all, thank you, Your
7 Honor.

8 JUDGE MOSS: Mr. Sherr, can you finish in 10
9 or 15 minutes?

10 MR. SHERR: I believe I can.

11 JUDGE MOSS: Okay.

12

13 R E D I R E C T E X A M I N A T I O N

14 BY MR. SHERR:

15 Q. Morning again, Mr. Mabey.

16 A. Good morning.

17 Q. Do you remember, it seems like hours ago,
18 Ms. Smith asked you a question regarding priorities in
19 claims in bankruptcy?

20 A. Yes, generally I recall.

21 Q. And I believe she asked you if generally you
22 understand how those priorities in claims in bankruptcy
23 work; do you recall that?

24 A. Yes, I do.

25 Q. And your answer to that question I believe

0751

1 was yes?

2 A. In effect it was, I am familiar with those
3 priorities.

4 Q. Okay. Could you please tell the Commission
5 where rate payer interests fit into that scheme?

6 A. Rate payers generally don't make the priority
7 list because they're not creditors. If a particular
8 rate payer had a refund coming or something, it might be
9 a creditor for that purpose.

10 Q. So in that scenario, would the rate payer
11 be --

12 A. A general unsecured creditor.

13 Q. Okay. And would the, I'm not sure how to ask
14 this question exactly, would the interest of that person
15 be due to the nature of that person being a rate payer?

16 A. No, no, I don't think so. In both the courts
17 in Public Service of New Hampshire and Pacific Gas &
18 Electric have concluded that rate payers just generally
19 aren't creditors.

20 Q. Thank you. Chairwoman Showalter asked you a
21 question regarding whether a bankruptcy court would take
22 into account, I believe she asked, the Commission's
23 motivation in a prebankruptcy order in which the
24 Commission conditioned the sale of an asset with certain
25 conditions; do you recall that?

0752

1 A. Yes.

2 Q. In connection with that question, what is to
3 your understanding the primary charge of the bankruptcy
4 court?

5 A. Well, the purpose of the bankruptcy laws, the
6 purposes of the bankruptcy laws are to, in Chapter 11,
7 are to effect a successful reorganization of the
8 company, treating creditors and other parties in
9 interest consistent with the statute, to provide a fresh
10 start, and to provide an equitable distribution to
11 creditors.

12 Q. So you would say that the primary focus is,
13 well, I don't want to put words into your mouth. Could
14 you -- strike that, I will withdraw the question.

15 Commissioner Hemstad asked you a question
16 whether it was possible that -- whether a scenario was
17 possible whereby the creditors of QC would become a
18 shareholder of QC; do you recall that question?

19 A. I think his question was, would the creditors
20 of QCI become the shareholders of QC, but I would defer
21 to the Commissioner.

22 COMMISSIONER HEMSTAD: That was my question,
23 I believe, or at least that was the intent of my
24 question.

25 MR. SHERR: Okay, I apologize.

0753

1 BY MR. SHERR:

2 Q. And I believe, although I appear not to
3 remember the question, I remember your answer as being,
4 possibly that could occur.

5 A. Yes.

6 Q. Is it also possible that QC would be sold to
7 satisfy creditors?

8 A. Yes.

9 MR. SHERR: Thank you, I have no further
10 questions.

11 MS. SMITH: Your Honor, the Commission Staff
12 moves for the admission of Exhibits 212, 213, and 214.

13 JUDGE MOSS: Is there any objection?

14 MR. SHERR: No objection.

15 JUDGE MOSS: All right, then they will be
16 admitted as marked.

17 And with that, Judge Mabey, we thank you for
18 your testimony today and appreciate you being here.

19 THE WITNESS: Thank you.

20 JUDGE MOSS: You may step down.

21 I think we are, well, I suppose we can save a
22 little bit of time by swearing our next witness at least
23 and getting him comfortably seated on the Bench, and
24 then we probably will take our lunch recess. We'll take
25 a 90 minute recess at lunch again.

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1

2 Whereupon,

3

JOSEPH P. KALT,

4 having been first duly sworn, was called as a witness

5 herein and was examined and testified as follows:

6

7 (Discussion on the Bench.)

8

JUDGE MOSS: Why don't we take advantage of
9 our ten minutes and put the direct on.

10

This is essentially a formality to get your
11 direct into the record, and then we will recess and have
12 our cross-examination after lunch.

13

Your witness, Mr. Harlow.

14

MR. HARLOW: Thank you, Your Honor.

15

16

D I R E C T E X A M I N A T I O N

17

BY MR. HARLOW:

18

Q. Good morning, Dr. Kalt. Please state your
19 name for the record.

20

A. Joseph P Kalt.

21

Q. And, Dr. Kalt, do you have in front of you
22 what have been marked as exhibits in this proceeding
23 261, 262 and 264?

24

A. Yes, I do.

25

Q. Were those exhibits prepared under your

0755

1 direction and supervision?

2 A. Yes, they were.

3 Q. If I were to ask you the questions contained
4 in Exhibits 261 and 264, would your answers be the same
5 as contained in those exhibits?

6 A. Yes.

7 MR. HARLOW: Your Honor, we move the
8 admission of Exhibits 261, 262, and 264.

9 MR. TRAUTMAN: No objection.

10 JUDGE MOSS: There being no objection, those
11 exhibits will be admitted as marked.

12 Now I had 261 has got some confidential
13 portions, is that still the case, or has all of that
14 been --

15 MR. HARLOW: I believe that's still the case,
16 Your Honor.

17 JUDGE MOSS: Okay.

18 MR. HARLOW: We still have some yellow.

19 JUDGE MOSS: There's still some confidential
20 to it but no highly confidential?

21 MR. HARLOW: That's correct.

22 JUDGE MOSS: Okay, well, I will make that
23 correction on the exhibit list.

24 All right, well, with that, let's be in
25 recess until 1:30, and we'll see you then, Dr. Kalt.

0756

1 (Luncheon recess taken at 11:50 a.m.)

2

3 A F T E R N O O N S E S S I O N

4 (1:35 p.m.)

5 JUDGE MOSS: We had, just prior to the
6 luncheon recess, we had Professor Kalt sworn and had his
7 direct became exhibits, and so he's ready for
8 cross-examination.

9 MR. HARLOW: He is, Your Honor.

10 JUDGE MOSS: All right, go ahead,
11 Mr. Trautman.

12 MR. TRAUTMAN: Thank you.

13

14 C R O S S - E X A M I N A T I O N

15 BY MR. TRAUTMAN:

16 Q. Good afternoon, Mr. Kalt.

17 A. Good afternoon.

18 Q. I'm Greg Trautman for the Commission Staff.

19 If you could turn to your supplemental rebuttal
20 testimony, I believe it's Exhibit 264.

21 A. Mm-hm.

22 Q. On page 1.

23 (Discussion on the Bench.)

24 JUDGE MOSS: Okay, we're there, Mr. Trautman,
25 thank you for pausing.

0757

1 BY MR. TRAUTMAN:

2 Q. On lines 18 through 20, you state:

3 In this supplemental rebuttal testimony,
4 I examined the economic implications of
5 Dr. Blackmon's new proposed conditions
6 on an otherwise Commission approved
7 sale.

8 Do you see that?

9 A. Yes.

10 Q. Do any of these implications to which you
11 refer affect Dex Holdings specifically?

12 A. I believe they do.

13 Q. And how is that?

14 A. Well, Dex Holdings is involved in this
15 proceeding, because I understand that they seek to have
16 the sale approved so that they can get on with their
17 business, and they have strong concern if it's not
18 approved obviously.

19 Q. But the implications that are referred to
20 assume the Commission approval of the sale, so given
21 that, how are they --

22 A. Well, I'm trying to phrase that in the way I
23 understood Dr. Blackmon to be looking at it where he
24 says, assuming the Commission that you approve the sale,
25 here are conditions, says Dr. Blackmon, that should be

0758

1 imposed. Now in my analysis I discuss that the actual
2 value of the conditions in terms of a commitment by
3 Qwest would be much larger, indeed about twice as large,
4 it would be about twice as large as the measurement of
5 imputation that Dr. Blackmon built into his what he
6 calls an annual contract payment. And my understanding
7 is that that would not be acceptable to the party or to
8 Qwest, and that even though the sale might be approved,
9 it wouldn't go through.

10 Q. So are you stating that if these conditions
11 were approved that they would exceed the limits of the
12 material regulatory impact and thus allow Qwest to walk
13 away from the sale?

14 MR. HARLOW: Object to the extent it calls
15 for a legal conclusion.

16 A. No, I'm not --

17 MR. HARLOW: You have to let the judge rule
18 on the objection.

19 JUDGE MOSS: I'm overruling the objection, go
20 ahead.

21 A. I'm not commenting in any way on the legal
22 implications.

23 BY MR. TRAUTMAN:

24 Q. So do you know, is it your opinion, not as a
25 lawyer but having examined the conditions, is it your

0759

1 opinion that these conditions would permit Qwest to walk
2 away from the sale? Because you indicated just
3 previously that they would not be acceptable to Qwest.

4 A. The way to look at it as an economist, the
5 word permit implies to me interpreting a contract or a
6 law, but the way I look at it as an economist is that
7 these conditions would make the sale very onerous, and
8 just to an economist it would make the sale less likely
9 to occur.

10 Q. Well, would Qwest -- if the conditions were
11 to be implemented, would Qwest have the option to get
12 out of the sale, whether it wanted to or not?

13 A. Well, I would presume that that would require
14 some interpretation of the law and the contract. I
15 would say certainly there you might expect discussions
16 between the parties, but that -- I can't interpret the
17 law.

18 JUDGE MOSS: Mr. Trautman, let me interject
19 here, if I may, because I want to be sure I understand
20 this point.

21 Professor Kalt, if you can, if you know the
22 answer, is it your testimony that the imposition of the
23 conditions proposed by Dr. Blackmon would cause Qwest or
24 the parties to incur \$500 Million or more in regulatory
25 expense in connection with the transaction?

0760

1 THE WITNESS: No, that's not my testimony.

2 JUDGE MOSS: Okay.

3 THE WITNESS: I have not studied that
4 question.

5 JUDGE MOSS: Thank you.

6 BY MR. TRAUTMAN:

7 Q. And again, so you have indicated, I think you
8 have indicated you're not sure whether they could get
9 out of the sale?

10 A. I can't provide you a legal interpretation of
11 the contract.

12 Q. All right. So assuming that the sale would
13 therefore go through and the buyer would get Dex, then
14 at that point how do these conditions, each affecting
15 Qwest, how do they affect Dex Holdings at that point?

16 A. You're asking me to assume the sale has gone
17 through and the two parties have walked away from each
18 other?

19 Q. Correct.

20 A. Well, at that point I don't think it would
21 affect --

22 Q. Well, not walked away, I'm assuming the sale
23 has been approved.

24 CHAIRWOMAN SHOWALTER: Has been executed.

25 A. Well, in that situation, the sale go through,

0761

1 and Dex would then own so called Rodney and all of Dex
2 and Qwest Dex.

3 Q. And these conditions would not affect Dex
4 Holdings, correct?

5 A. If the sale went through in the way you
6 describe it, I think that's right.

7 Q. If you could turn to page 4 of the same
8 testimony, and actually it's a carryover paragraph from
9 page 3 where you refer to Dr. Blackmon's use of business
10 forecasts. And then on the top of page 4 you ask a
11 series of questions and say:

12 Moreover uncertainties of this type
13 generally increase over time since it is
14 easier to get a handle on likely
15 conditions tomorrow or a year from
16 tomorrow than it is to do so for 40
17 years from now.

18 Now are you saying that the Dex buyers
19 attribute no additional value to the out years of the 40
20 year period?

21 A. No, that's not what that says.

22 Q. And on the next sentence you talk about, you
23 say:

24 Indeed, with long lived assets, this is
25 one reason why actual bids by buyers for

0762

1 businesses are often framed in terms of
2 valuation multiples of some measure of
3 current income such as EBITDA.

4 Do you see that?

5 A. Yes.

6 Q. Does the buyer's multiple vary with the
7 number of years that the buyer will hold the asset?

8 A. If we're in this context where I'm talking
9 about where your degree of certainty is declining or
10 deteriorating as you look out farther and farther, that
11 will tend to pull the multiples down.

12 Q. So it will vary, is that --

13 A. Well, given the presumption in this context,
14 reading in context that your degree of certainty is
15 decreasing as you look out farther and farther years as
16 a general matter.

17 Q. All right, let me phrase it this way. All
18 else being equal, would the multiple be different if,
19 for example, the non-compete agreement ended in 15 years
20 rather than 40?

21 A. You might expect the multiple to be
22 different, but for a different reason now. You have
23 changed -- you said all else equal, but now you have
24 changed a different component of the contractual
25 relationship.

0763

1 MR. TRAUTMAN: I think that's all I have,
2 thank you.

3 JUDGE MOSS: Turn to the Bench.

4

5 E X A M I N A T I O N

6 BY CHAIRWOMAN SHOWALTER:

7 Q. Good afternoon.

8 A. Good afternoon.

9 Q. I see you have been with us the whole week.

10 A. I have.

11 Q. At least you're probably on the right time
12 zone.

13 A. I apologize for coughing in the back there
14 all the time, I'm fighting a bad cold.

15 Q. I would like to ask some questions about
16 gauging the value of the imputation and credits over
17 time. If you are able, can you tell me what the net
18 present value of the rate payer benefit is if we assume
19 that the short-term cash is paid and we assume that all
20 of the imputations and credits are, in fact, delivered
21 to the rate payers?

22 A. Actually done a calculation of that, and I
23 touch on it in my latest filing that I made. I think
24 that the value of the imputation through 40 or 50
25 years --

0764

1 Q. Well, no, I'm talking about the settlement
2 proposal, I'm sorry.

3 A. Oh, the settlement proposal.

4 Q. Yeah.

5 A. The settlement proposal, if phrased as a
6 revenue credit as Mr. Mabey was talking about today, and
7 that's my understanding is how it's phrased at the
8 moment in the settlement, it has a value of about \$1.2
9 Billion, and let me explain where that comes from.

10 The settlement agreement turns what had been
11 imputation, which had been dependent upon the excess
12 earnings of the Yellow Pages company and thereby bearing
13 business risk, it takes that imputation and now creates
14 a schedule of payments as a revenue credit. And as
15 Mr. Mabey says, said today, that revenue credit he said
16 would be very secure, and his word was trump, it would
17 trump the bankruptcy process because -- if it was in his
18 view phrased as a I think he called it a rate order. In
19 other words, it was a, as I understood him, as an act of
20 this Commission in terms of pricing, it could withstand
21 the bankruptcy process. The implication of that is that
22 the risk of the -- receiving those payments is reduced.
23 That's why this Commission has been so interested. You
24 can intuit that it's more valuable to the rate payers if
25 it's more secure.

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1 And the \$1.2 Billion that I mentioned, I have
2 calculated by, well, we're no longer imputing a business
3 difference between revenue and cost, it's not risky
4 because of business risks. If you use, for example, a
5 20 year T-Bill rate, Treasury bill rate, take the
6 business risk out of this, it's just a schedule of
7 payments as a revenue credit, then you conclude that the
8 settlement has a value of \$1.2 Billion.

9 Q. All right, so my question was, and I think
10 you answered it, I want to know simply as a matter of
11 mathematics and interest rates.

12 A. Yeah, 1.2.

13 Q. So that the \$1.2 Billion, is 67 --

14 A. Is 67 up front, then 110 for four years and
15 103 and something for 11 years.

16 Q. All right. Now my next question though is
17 that would you say that if the rate payers were to
18 receive \$1.2 Billion on the day after the sale that that
19 is more certain, that would be a more certain payment
20 than receiving the credits over time?

21 A. Sure.

22 Q. So isn't the, perhaps net present value isn't
23 the correct term, maybe it's something like net present
24 value adjusted for uncertainty over time, the actual
25 dollar amount would be something less than \$1.2 Billion?

0766

1 A. If you wanted a certain equivalence you mean?

2 Q. Right, if you were to introduce a probability
3 of recovery of all of the imputation, that probability
4 would be less than 1?

5 A. Yes.

6 Q. So therefore that mathematical proposition of
7 \$1.2 Billion would have to be reduced perhaps by some
8 amount that's not known because we don't know the
9 probability, but it would be less than \$1.2 Billion?

10 A. Not necessarily. I could say it this way.
11 By discounting with a discount factor, that has some
12 risk associated with it, the risk in the case that I
13 just gave you of 20 year T-Bills. There's some risk
14 already in that. Given that, given that, you said
15 there, well, there should be more risk, then you're
16 right.

17 Q. Well, I guess a way to put it would be if you
18 had the choice, kind of like the Lotto winners, but if
19 you had the choice of taking \$1.2 Billion today and this
20 schedule of payments, assuming they were actual real
21 payments, no, not assuming they're actual payments,
22 assuming they were payments that had the uncertainty
23 that credits and imputation might have, which would you
24 rather have?

25 A. I think it would -- it would depend entirely

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1 on whether you thought that this risk of nonpayment was
2 greater or less than the risk that is implicitly in that
3 discount rate. If you're -- do you see what I'm saying?

4 Q. Yes.

5 A. If you thought, well, there's still -- still
6 more risk that Kalt hasn't accounted for, then I would
7 prefer something -- I would accept an amount less than
8 \$1.2 Billion. On the other hand, if I said, look,
9 Mr. Mabey says it's very secure, it can trump the
10 bankruptcy and so forth, then it's a relatively risk
11 free stream. I would say, well, it might be a pretty
12 good deal to take the 1.2 rather than -- I guess the
13 Staff says the gain from the Washington portion of the
14 sale is --

15 MS. ANDERL: Confidential number.

16 A. Oh, I can't talk about that, is less than 1
17 -- can I say --

18 Q. That's all right.

19 THE WITNESS: Sorry, Lisa.

20 MS. ANDERL: That's okay.

21 BY CHAIRWOMAN SHOWALTER:

22 Q. Is what we're assessing right now the
23 relative risk of your T-Bill projections versus the
24 relative risk -- versus the risk of not collecting on
25 all of the imputation and credit over the next 15 years?

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1 A. Yes.

2 Q. All right. On that question, do you have a
3 judgment, do you have an opinion as to whether the risk
4 that you did incorporate into your T-Bills is great --
5 is less than the risk that the imputation and credits
6 may not be actually received over the next 15 years?

7 A. I do have somewhat of a judgment.

8 Q. What is it?

9 A. I'm afraid it won't be quite as crisp as yes
10 or no, but I tried to think that through as Mr. Mabey
11 was talking this morning, in fact. And it was pointed
12 out either in response to questions from you or from
13 Commissioner Hemstad that the situation in which you
14 might run into trouble, I think you used the phrase
15 there wasn't enough money, would be a situation in which
16 QC itself wasn't solvent, it couldn't raise money, et
17 cetera. And when I think about that scenario, as
18 Commissioner Hemstad pointed out, it's a basic public
19 service, mankind out here presumably is going to like
20 telecommunication services, how could we get into a
21 situation in which there, to use your phrase, there
22 wasn't enough money and we got into trouble.

23 I think it would be a situation in which
24 either costs are too high or revenues are too low. If
25 costs are too high because of imprudent actions, you

0769

1 have the authority, of course, to reject those costs.
2 If revenues are too low, it would, I believe, as I think
3 through the economics of it, it would mean that we have
4 entered into an era in which the rates that you're
5 trying to set aren't achievable in the market anymore.

6 That is, the rate that reflects this revenue
7 credit and would recover all the costs isn't achievable
8 in the market anymore, and it would be because in some
9 sense the other policies of trying to move toward
10 competition have brought in substitutes and so forth. I
11 don't know how to make a call as to whether that would
12 actually happen or not, so it could turn out that you
13 wouldn't in that sense receive all of the revenue
14 credits.

15 But I think you would conclude it would be
16 for a good reason. That is, you now are in a world in
17 which there are so many substitutes that QC can't get
18 its rates up to the levels that the Commission deems to
19 be fully recovering costs minus the revenue credit.

20 Q. Well, but I guess I'm wondering why that is
21 the scenario you think would be the case, because in a
22 regulated company normally you add up the expenses, put
23 in some amount for profit, divide by the number of rate
24 payers, and that's a rate case, only it takes 11 months
25 to do that.

0770

1 A. Yes.

2 Q. But in this case, we would be adding up the
3 expenses, adding something in for profit, subtracting
4 the amount of the revenue credit, and then dividing by
5 the number of rate payers and getting the rate.

6 A. Mm-hm.

7 Q. And I think it gets back to whether the
8 credit would eat up --

9 A. All the equity.

10 Q. -- all of the profitability or more, or if it
11 ate up a lot of the profitability over many years, what
12 would that do to the company. So I'm a little bit
13 uncertain that your scenario is the only one, that is
14 competition has taken hold, prices have come down, and
15 really regardless of the credit the company simply can't
16 deliver the service at a competitive rate anymore. But
17 once you add in that credit, you're in a different
18 calculation.

19 A. I guess you're right, there could be a zone
20 in the sense where the equity value could somehow in the
21 world with no imputation have been sustained at a level
22 where you were still solvent but the revenue credit
23 maybe ate that up concerning some zone as you were
24 having this downward pressure on your rates for some
25 reason.

0771

1 Q. So maybe the question is, how big is that
2 credit relative to the typical amount of profit that we
3 allow our regulated company? And I don't know the
4 answer to that. I don't know if it's --

5 A. I don't know the answer to that.

6 CHAIRWOMAN SHOWALTER: I don't know if it's
7 confidential, but, Ms. Anderl?

8 MS. ANDERL: I don't know the answer, but I
9 know that Mr. Reynolds can talk to you about that type
10 of issue.

11 CHAIRWOMAN SHOWALTER: All right.

12 MS. ANDERL: When he's on the stand on
13 Wednesday.

14 CHAIRWOMAN SHOWALTER: All right.

15 BY CHAIRWOMAN SHOWALTER:

16 Q. Then but do you agree that what we're doing,
17 what we, what the settlement proposes to do in the first
18 instance is eat into the profitability of the company?

19 A. I think that's right, yes. Absent the
20 revenue credit, your rates, the rates set by the
21 Commission would be fully recovering expenses plus a
22 cost of capital rate of return, and another revenue
23 credit will hold things down from that.

24 Q. And as we heard earlier that the
25 justification for that would be that that profitability

0772

1 was already realized by the sale of Dex in those
2 proceeds that are going to be paid out post sale. I
3 mean --

4 A. Well --

5 Q. -- it may not be an exact tradeoff, but we
6 would be justified, I think is what Mr. Mabey, was it
7 Mr. Mabey, said earlier, that to squeeze the
8 profitability of the regulated company because that
9 amount of profit had been taken by QCI at an earlier
10 stage, namely the sale of Dex.

11 A. Well, I can see that reasoning. It sounds
12 like a sort of legal conclusion, but I would say that
13 the settlement has the character of the settling parties
14 essentially saying there is this commitment to have --
15 having a revenue credit for 15 years and being
16 susceptible to the rate making that you just -- you just
17 described. That's their commitment that they're making.

18 Q. But now back to my actual -- my actual
19 question wasn't would it be all right if -- would things
20 be all right if this credit weren't realized, it was
21 very specifically, do you think that the probability of
22 the credit not being fully paid is greater than the
23 probability of your T-Bill discount that you're
24 proffering?

25 A. Again, you can tell that I'm thinking this as

0773

1 I'm listening to Mr. Mabey, my initial response would be
2 to say no. I think that -- and there's an underlying
3 economic reason for that. The purchase here comes in --
4 the revenue is received as a lump, if you will, and it's
5 a kind of sunk event from the point of view of the
6 company. That's -- I think Mr. Reynolds may have
7 greater information about the sort of typical cash flows
8 and so forth, but my understanding, that would be the
9 best answer I could give you.

10 Q. I mean if you could buy a T-Bill today or you
11 could buy the equivalent amount in a revenue credit 15
12 years from now, which would you buy?

13 A. Oh, spread over 15 years.

14 Q. I'm just talking about the 15th year. Let's
15 say there is a payout 15 years from now, which would you
16 buy?

17 A. Well, I guess right now I'm essentially
18 buying the T-Bills, because I keep investments in
19 T-Bills. And, you know, like my retirement accounts,
20 I'm saying I can't get at them for so many years, and
21 I'm willing to do that. You're asking exactly the right
22 question, I think, in terms of these relative risks.

23 To some extent, of course, the risks that
24 you're asking about are ultimately judgment calls that
25 you have to make on everything from will you get into a

0774

1 zone where the revenue credit is somehow the straw
2 that's breaking the camel's back, will you be in a
3 period in which competition is stronger and you're glad
4 the revenue credit isn't being passed through in the
5 sense that you have achieved the goals of having more
6 substitutes. So you're asking the right question, I'm
7 -- I can't give you a firmer judgment than what I have
8 given you.

9 Q. Well, the truth is we simply don't know the
10 future. We can't see five years ahead. But if I look
11 five years ago or maybe even three years ago and think
12 about the promises that were made, for example, on the
13 benefits of the merger, Qwest, they clearly did not come
14 to pass. And so that doesn't mean everything
15 necessarily does not work out the way you want to or
16 sometimes it can work out better, I have seen examples
17 of it. I would have thought it's almost a given that
18 the further out in time, the less certain you are, and
19 that if we're talking about the probability of a
20 payment, it's not the probability of what that payment
21 is valued at if it's paid, it's just the probability of
22 even getting it has to be less.

23 A. Than 1.0?

24 Q. Right.

25 A. Right, exactly.

0775

1 Q. So then you get into your T-Bill discussion?

2 A. Right, right.

3 Q. Here's another scenario. Why wouldn't we
4 want to deliver to the rate payers immediately the
5 maximum portion of the \$1.2 Billion that they are owed,
6 assuming that's what they are owed, that doesn't
7 jeopardize QCII? In other words, why wouldn't we want
8 to get the most we could into their pockets now but
9 without threatening the overall being of the companies?

10 A. First, just to be clear, the Staff's
11 calculation of the Washington state portion of the gain
12 is like 1.1 --

13 MS. ANDERL: Confidential number.

14 A. I'm sorry, I keep forgetting that.

15 Okay, but I understand your question. I
16 think that it has to do with the implied risk that
17 you're taking. Your question says, without essentially
18 pushing the company into or the rate payers into a world
19 they don't want to be in. And so you're having to from
20 that perspective make a risky decision. And there's a
21 saying we say when we teach our students, you know, if
22 there's someone try to put you on the plank and puts a
23 blindfold on you and tells you to start walking, you
24 take little steps because you, you know, you're trying
25 not to go over the edge. And so the very essence of

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1 your question implies the risk that you're concerned
2 with.

3 Q. Well, right, and I think I'm just thinking
4 conceptually. Maybe I don't know right where that line
5 is, and maybe there are different views, different
6 opinions about where that line is, and so maybe I should
7 be conservative and keep back off the thin ice. But why
8 wouldn't I want to give sort of the a bird in the hand,
9 as big a bird as I thought I could do maybe even
10 conservatively as opposed to 1 month's credit and the
11 rest over 15 years?

12 A. Well, if your goal was to maximize the near
13 term benefit, then you would make the conservative
14 decision that you were just implying. So the principle
15 at work, you know, I think you're reasoning about it
16 correctly, the challenge it seems to me for anyone is to
17 -- is to ask the question about -- about the -- where's
18 the end of the plank, if you will.

19 Secondly, because there are, I mean the
20 language of risk, I'm sorry, I'm getting a little --
21 you're asking a hypothetical, so I answer you like a
22 professor. But in the language of risk we would say
23 there are states of the world in which such as your 13,
24 14, 15, competition is now fully in place, and so forth
25 and so on. There are states of the world in which in a

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1 sense your policies have delivered rate payers benefits
2 through another avenue, through the introduction of
3 competition, and you then will -- would have said, well,
4 for a good reason I don't have 100% probability of
5 wanting to collect the 13th year or the 14th year.

6 And so that leaves you saying let's put in
7 place a process that removes this imputation from
8 business risk, and your promises made during mergers and
9 so forth are reflective of business risk. This has its
10 character of becoming a schedule of payments, let's
11 remove it from that and give it the characteristics of
12 what Mr. Mabey has said, because we're not going to
13 collect it all.

14 Q. So you're saying if in the end the credit
15 isn't given, if it's because other companies were
16 offering lower prices and the rate payers got a
17 different kind of good deal even though they didn't get
18 the payout that they -- we originally said they were
19 entitled to.

20 A. That's correct, or different services, you
21 know, new technology services or whatever, yes.

22 CHAIRWOMAN SHOWALTER: I had another
23 question, but it left my head, so thank you.

24

25

1 E X A M I N A T I O N

2 BY COMMISSIONER HEMSTAD:

3 Q. Just so I'm clear on this, Mr. Trautman gave
4 you the hypothetical of Washington, the company, care if
5 the sale goes through of whether the conditions such as
6 Dr. Blackmon has proposed were put in effect, and I
7 think ultimately your answer was it shouldn't.

8 A. No, not quite. What I have tried to convey
9 is that the question as I understood it was a version of
10 Dr. Blackmon's policy of requiring a set of payments
11 over the years equal to some forecasted imputation. And
12 what I said there was that the value of that would -- I
13 think I said it would put an agreement under strain as
14 an economist. It's now made going forward with the
15 agreement more -- it's put it under strain. Whether
16 puts it under so much strain that it breaks it or not, I
17 don't know, but I can say as an economist before the
18 fact you would put the agreement under strain.

19 Q. The burden would be potentially too high and
20 then incentive to try to break the agreement?

21 A. It might be to break it. We know in business
22 quite often when an agreement comes under strain parties
23 often will first approach each other with good will and
24 say, you know, we're in a situation we didn't
25 anticipate. The other side might say, you should have

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1 anticipated it, but we do know that businesses in the
2 real world when their agreements are put under strain,
3 that creates prospects of breach, of renegotiation, of
4 settlement out of the agreement, and so forth. That's
5 all I can say.

6 Q. So I take it from that, it would be your
7 position that were the Commission to impose such
8 conditions, that would increase the likelihood of
9 jeopardizing the sale itself?

10 A. That is certainly one aspect that I
11 understand would come under strain. Whether it would,
12 I'm trying to not go beyond what I can say in my role,
13 whether it would cause parties to take actions that
14 resulted either in breach or something else that caused
15 the sale not to occur, I think you would have to ask the
16 companies that. All I can say is what direction the
17 economists are saying it's been pushed, and that's the
18 point I have made.

19 Q. Well, then assuming on a going forward basis
20 that QCII continues despite the sale to be in a state of
21 financial jeopardy or there is substantial risk of that,
22 how should this Commission then attempt to protect in a
23 sale environment the interests of Washington rate
24 payers?

25 A. When I put on my public policy hat and

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1 provide that advice to you, I would say, and I will
2 preface this by saying, assuming, I'm a non-lawyer,
3 assuming my understanding of what Mr. Mabey has written
4 about and said, I believe that an appropriate -- the
5 appropriate strategy for you at this point is to accept
6 this settlement, which does have present value as we
7 have just discussed. There's always risk, but it does
8 have a present value which exceeds what the Staff says
9 is the Washington state portion of the sale. And if I
10 understand Mr. Mabey, I think what he is saying to us is
11 that the revenue credit avenue provides you greater
12 assurance than a number of the other avenues in terms of
13 what the bankruptcy scenarios provide you.

14 Q. Okay. I will keep this in a hypothetical
15 format in order to abstract it here in a conceptual
16 environment. All right, assume a parent company under
17 significant financial strain with a profitable regulated
18 subsidiary. Why should -- why wouldn't the parent be
19 strongly incented to, anyway it could, to bleed money
20 out of the subsidiary in order to assist it in dealing
21 with its financial problems?

22 A. Because any capital that it acquires from the
23 profitable subsidiary in the language of economics has
24 an opportunity cost, and it's not free to a company
25 since the investors could claim it, for example, by

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1 selling off or putting the weak assets on the market,
2 for example, getting rid of those. It's not in the --
3 certainly in the long-run interests of creditors or
4 shareholders to pour money down a losing proposition.
5 You don't get it back. And so for that reason, that
6 would be a reason why you would, in fact, either sell
7 off a weak asset, or depending on your legal structures,
8 put it into bankruptcy.

9 Q. Well, the recent scenarios in the utility
10 industries in this country today, both in energy and
11 telecom, where you have multiple corporate structured
12 environments is that the parent is intensely motivated
13 because of its short-term problems to get the money
14 wherever it can find it and worry about the long-term
15 consequences later. Do you agree with that general view
16 of what has been happening in the last two or three
17 years in this country?

18 A. Well, I would say I think I have probably
19 seen some behavior like that. But on the other hand, as
20 Mr. Mabey described, we have had these cases, for
21 example, on the energy side where as an act of the
22 owners of the firm they ring fenced the profitable
23 asset.

24 Q. I am aware of one, and that's Enron.

25 A. And then in other instances they have sold

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1 off profitable assets in order to garner cash. Because
2 that's the way to maximize the receipt of cash is not to
3 depreciate its value by throwing it into losing
4 operations, but to keep them, either turn them into cash
5 by selling a profitable operation or to ring fence them.

6 Q. You're not suggesting, are you, that there
7 are not scenarios out there that have occurred today
8 where --

9 A. No, as I say, I think I have seen some of
10 that.

11 Q. -- the consumers of regulated companies have
12 been harmed by the actions and conduct of parent
13 corporations because of their unregulated activities?

14 A. I think that's probably happened, true.

15 Q. I am looking at your original rebuttal
16 testimony, which is Exhibit 261, the paragraph that
17 begins at line 4 1/2.

18 A. Which page?

19 Q. I'm sorry, page 4. And I think this also
20 comes up and you make similar statements or statements
21 somewhere in your latest rebuttal testimony, but with
22 the phrase or reading the first part of that:

23 The telecommunications industry is well
24 down the path toward competition, and
25 the directory business is facing

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1 increasing competition from independent
2 Yellow Pages directories, the Internet,
3 and other media.

4 Confining my question to the printed Yellow
5 Pages side, is your view that Dex faces substantial
6 competition for its offering?

7 A. I would say that -- hard to judge what the
8 word substantial means. It's certainly growing.
9 They're facing as many as five new entrants a year,
10 their share of the overall revenues has gone down from
11 their earlier period when they were essentially the only
12 one. I think the numbers are in the range of 70% to 75%
13 of the revenues now.

14 Q. I'm sorry, 70% to 75%?

15 A. 70% to 75%.

16 Q. Of the revenues of what?

17 A. Of Yellow Pages advertising, as I understand
18 it. And so they have had these large inroads made into
19 their business.

20 Competition occurs at the margin in all of
21 the -- the attorneys outnumber the economists here
22 probably 15 to 1 in this room, and you all have had
23 antitrust economics to some extent I presume, and you
24 know that we say, like the Department of Justice merger
25 guidelines, market share is only a starting point for

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1 analyzing whether firms are under competitive or market
2 power conditions, and the relative frequency and ease of
3 entry that we have been seeing says that competition at
4 the margin to go get the next line of business is indeed
5 subject to competition.

6 Q. And do you know that as a fact?

7 A. Yes. If you look in the data, I can't
8 remember the data response number, I think it's a
9 Mr. Reynolds data response, they provide you there with
10 the data regarding entry, exit, and so forth of
11 independent Yellow Pages.

12 Q. Well, perhaps I will pursue that with
13 Mr. Reynolds. I saw your footnote reference to that,
14 and I tried to look up those references, and I -- it was
15 not informative. I couldn't pin down that information.

16 A. That's because there's a typo in your -- it's
17 been corrected in the record.

18 MR. HARLOW: Is it possible that that was the
19 Footnote 7 that we corrected?

20 THE WITNESS: No, it's not 7.

21 COMMISSIONER HEMSTAD: No.

22 CHAIRWOMAN SHOWALTER: Where is it?

23 COMMISSIONER HEMSTAD: I don't know, it may
24 be in the original testimony.

25 Judge Moss, that's what I was asking.

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1 JUDGE MOSS: The exhibits we were discussing
2 last evening?

3 COMMISSIONER HEMSTAD: Yeah.

4 JUDGE MOSS: It's in the latest round of
5 testimony, and it is a reference to -- I think it's in
6 the latest round. Maybe it wasn't. Anyway, it was a
7 reference to responses to Staff data requests, and I
8 think it said 6I and 7I.

9 COMMISSIONER HEMSTAD: Or 6I to 7I.

10 JUDGE MOSS: But I think on second look it
11 actually said 6I and 7I, and I was trying to find those
12 and couldn't.

13 MS. ANDERL: Yes, Your Honor, I have an
14 explanation for that. It may be that Dr. Kalt when he
15 drafted that did not understand that not all of the data
16 requests were in the record. They are numbered 6I and
17 7I for interrogatories, because Staff sent us requests
18 for admission that had overlapping numbers, so those
19 were 6A and 7A just so you know what we did. We
20 certainly have those documents here in the room, they're
21 available. They were not heretofore attached to any
22 parties' testimony, nor were they identified as cross
23 exhibits. So unless Your Honor wants them, they would
24 not otherwise become a part of the record.

25 JUDGE MOSS: Would you like to look at those?

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1 COMMISSIONER HEMSTAD: Yes, I would.

2 JUDGE MOSS: Yes, if those could be furnished
3 to the Bench, and I can't find the reference now either,
4 but you know what I'm talking about plainly, so.

5 MS. ANDERL: I know exactly which ones. Is
6 that Bench Request Number 5, Your Honor?

7 JUDGE MOSS: Is it possible we could be
8 furnished with those right now?

9 MS. ANDERL: Yeah, we don't have multiple
10 copies.

11 JUDGE MOSS: That's all right.

12 MS. ANDERL: We could hand up the one though.

13 JUDGE MOSS: Hand up the one.

14 CHAIRWOMAN SHOWALTER: Also, if you could
15 point out in Dr. Kalt's testimony where the reference is
16 so we could write it in.

17 COMMISSIONER HEMSTAD: And I have lost it
18 now.

19 JUDGE MOSS: I have too, I had it earlier.

20 MR. CROMWELL: I think we're looking at page
21 20, Footnote 31.

22 JUDGE MOSS: Yes.

23 MR. CROMWELL: Is that the one?

24 JUDGE MOSS: Thank you, that is where we're
25 looking.

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1 COMMISSIONER HEMSTAD: That's in?

2 JUDGE MOSS: In the original testimony,
3 Exhibit 261.

4 THE WITNESS: Oh, right, that's correct.

5 JUDGE MOSS: We'll get copies and so forth
6 later, but let's go ahead and identify this as Bench
7 Request 5.

8 And while Commissioner Hemstad is studying
9 those a little bit, let me take care of a housekeeping
10 matter with respect to Bench requests and records
11 requisitions. Typically, well, often I should say we do
12 those in writing and are thoughtful enough to include
13 response dates, and we've been doing them orally, and I
14 have not indicated response dates. I have proceeded on
15 sort of an as soon as possible basis, and I would like
16 those provided on that basis. However, I would like
17 them provided by next Tuesday so that we have them for
18 the responses by the time we get back into hearing next
19 week on Wednesday. So I want everybody to do their best
20 to get responses to record requisitions and Bench
21 requests by that time, if not sooner.

22 MR. HARLOW: Your Honor.

23 JUDGE MOSS: We could make it just Bench
24 Request 5 will be for, well, maybe we should make it 5
25 and 6, that way we'll make it separate exhibits. So 5

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1 will be for Exhibit, I'm sorry, response to Data Request
2 or Interrogatory Request 6, was it 6 and 7, 6I and then
3 the other one would be 7I.

4 MR. HARLOW: Your Honor, if I might ask the
5 witness if he has his own copies of those --

6 THE WITNESS: No, I don't.

7 MR. HARLOW: -- documents with him.

8 Oh, okay, I thought it might help him answer
9 questions if he had them.

10 BY COMMISSIONER HEMSTAD:

11 Q. In a market where there is substantial
12 competitive true choice, would the result of that be
13 that returns on equity would be relatively low?

14 A. Returns on book equity could be quite high,
15 for example, if there's a lot of relational assets, what
16 are called good will and other intangibles, they can be
17 -- they can be quite high on book equity. There is a
18 huge amount of research on the question that you're
19 asking, and I would say that with respect to reported
20 profitability we find some modest correlation in the
21 research but not overwhelming that says overall a lot of
22 different industries, greater numbers of competitors are
23 associated with lower levels of profitability.

24 Q. I am reading from the response in Request
25 Number 6I and referencing to Mr. Grate's testimony but

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1 -- and it's relatively lengthy, but it says here:

2 Of the original 8 publishers, 3 still
3 published Washington directories in
4 2002.

5 Would you say that's a significant amount of
6 competition?

7 A. I don't know exactly where you're reading.
8 As I recall, that data gives you sort of area by area
9 numbers.

10 Q. It's in response to the question:
11 Identify specifically by company name
12 each and every one of the directory
13 publishers being referred to in the set
14 of testimony who have entered and/or
15 departed the directory publishing
16 business in Washington state over the
17 last 20 years, and for each company
18 provide the date of entry and where
19 appropriate date of departure as
20 discussed in the answer.

21 But then it says:

22 Of the original 8 publishers, 3 still
23 published Washington directories in
24 2002.

25 In other words, there have been substantial

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1 numbers who have entered but many of whom have exited.

2 A. Without looking at their data, I hesitate to
3 give you an answer. When I counted, I actually went
4 through and counted, and what I saw was a pattern in
5 which as I recall they got to about 20 different areas
6 with competition in them. There was entry and exit
7 indicating low barriers to entry. If it were the case
8 that there were entry and exit but entry was relatively
9 easy, of course easy entry is a key component of a
10 competitive marketplace and allows competition to occur
11 at the margin.

12 MR. HARLOW: It seems to me, Your Honor, I
13 wonder if it would be possible on some of these
14 questions for the witness to borrow the copy from the
15 Commissioner to help him answer.

16 COMMISSIONER HEMSTAD: I wasn't going to
17 pursue it any further than that, at least with regard to
18 this, but if the witness wants to look at it.

19 MR. HARLOW: Thank you, Commissioner.

20 A. Commissioner Hemstad, it indicates that
21 between 1981, I'm reading from Data Response 6I:

22 Between 1981 and 2002, 35 publishers are
23 known to have entered the market, and 25
24 publishers are known to have exited the
25 market.

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1 It then says as you were saying:
2 Of the original 8, 3 still publish
3 Washington directories.

4 I believe those, I would have to look in the
5 data, I believe those refer to 8 who were there in 1981
6 when that count began, that there had actually been
7 entry of 35 publishers, exit at one time of 25, some of
8 the originals had stayed, and so that as I recall in
9 2001 or 2002, as I recall there were I think 13
10 publishers active in Washington.

11 BY COMMISSIONER HEMSTAD:

12 Q. Well, would you characterize Yellow Pages as
13 a highly profitable operation?

14 A. I think it has proven to be a highly
15 profitable operation, yes.

16 Q. And on a sustained and continuing basis?

17 A. Yes, I think so.

18 Q. This was going back a bit in time, but in our
19 order in 950200, which was the 18th supplemental order,
20 which was the final order in that case in which the
21 Yellow Pages issue was addressed, and at page 41, and
22 this is of that opinion, I'm going to read it to you, it
23 references the testimony of Mr. Brosch, a witness in
24 this proceeding, where it says:

25 We note Mr. Brosch's testimony that U S

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1 West Direct, the predecessor of Dex,
2 grossed approximately \$1 Billion and
3 earned a return of 205% in 1994, his
4 contention that for Washington
5 operations it earned 229% and his
6 contention that U S West Direct's return
7 on equity has exceeded 150% every year
8 since 1989 when publisher fees ended.

9 I would assume you would agree that's rather
10 impressive rates of return?

11 A. Yes, definitely.

12 Q. Do you have any reason to believe that that
13 is not the case today?

14 A. Well, I think that when we look at the
15 situation today and looking toward the future, it does
16 appear that this business can generate profitability and
17 in substantial amount. That's what's made it valuable
18 on the market when it's been put up for sale.

19 Q. Just pursuing that point, very high rates of
20 return on equity would suggest something approaching a
21 threat of monopoly, wouldn't it?

22 A. Well, again, but things change over time, and
23 the threat of entry causes competition to -- causes
24 competition to occur, so rates of return on historic
25 book equity can be very high, particularly as you come

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1 out of a period in which you had no entry or very little
2 entry.

3 Q. Again in your original rebuttal testimony at
4 page 20 at line 11 1/2, the sentence there reads:

5 The assets that constituted the
6 directory business in 1983 are very
7 different from the Qwest Dex assets
8 today.

9 So what inference is one to draw from that in
10 view of the position of this Commission that the
11 directory activities would be treated as if they were
12 continuing to be part of the regulated company?

13 A. Well, I comment either here or earlier in my
14 original rebuttal testimony that I think it's consistent
15 with that policy, and it's understandable that as this
16 industry beginning in the early 1980's began to enter an
17 era of more competition that you would go through a
18 transition period in which you would make the kinds of
19 decisions that you have made. The inference that I draw
20 from what I say here is that the argument that has been
21 made and that I was rebutting there is an argument that
22 I understood to be what I have called in this latest
23 filing what economists call a linchpin argument, it all
24 started with the regulated company.

25 And I have tried to point out that that's not

0794

1 consistent with sound economic reasoning. Sure, it's
2 valuable to have a relationship with the historic
3 telephone company. There's no question about that. But
4 in order to respond to what the market is looking at as
5 it goes forward, you have to have the people and the
6 other assets in place and the strategies, and those are
7 just different from what existed in 1983. The Internet
8 wasn't even around. You didn't have a strategy to
9 respond to the Internet because it wasn't there. That's
10 the point I'm trying to make to you.

11 Q. No, I understand. I was going to ask you
12 about your footnote discussion on linchpin theory, page
13 5, Footnote 9 of your most recent rebuttal testimony.
14 And I think I understand the point that you're making,
15 which I take it to mean that any enterprise is dependent
16 upon the experience, expertise, and performance of its
17 employees.

18 A. Yes.

19 Q. I mean that's a truism, I suppose. But take
20 the example of a company with a very valuable patent, it
21 has a monopoly on that product, but it's not self
22 executing, it will take skill, performance, and all of
23 such qualities in order to translate that patent into
24 profits; isn't that true?

25 A. Sir, I think the way to think about that is

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1 imagine I have a patent. I'm an inventor in my garage,
2 I invented something, but I don't know how to produce,
3 mass produce what I need to produce. I, in fact, may
4 not be able to produce the value for consumers from
5 that. My strategy might be to lease to a manufacturer
6 and take royalties, but what does that tell you? It
7 means that the manufacturer is bringing something to the
8 patent as well, and that's why in all production
9 activities, all of these inputs are necessary. And the
10 notion that there's one single input that all value
11 hinges on is a fallacy of economic reasoning. So I
12 think your patent question is a good question, and it
13 illustrates that just that asset, that linchpin doesn't
14 create all the value.

15 Q. Well, then finally on page 7 of your latest,
16 your supplemental rebuttal at line 4, you are responding
17 to Dr. Blackmon. You say, Dr. Blackmon asserts, for
18 example, that:

19 QC has a junk bond rating because of and
20 only because of its parent company.

21 Are you suggesting that QCII's problems
22 result from anything other than its activities?

23 A. In the context, sir, what I was referring to
24 was that there are well known external events, downturn
25 in the economy, rise of new technologies and so forth.

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1 In the context in which I was quoting this, I was
2 referring to Dr. Blackmon's discussion in which he
3 points to assertions and charges that have been made
4 about illegal behavior or something of that character,
5 and I'm trying to point out that if one wants to sort of
6 perform a prudence review, one has to take into account
7 the economic environment that are causing QCII's
8 position to be what it is.

9 Q. It's your term I guess, but I'm not sure that
10 the issue of prudence of QCII is an issue in front of
11 us.

12 A. Well, what I say in my testimony in
13 supplemental testimony is Dr. Blackmon, one of the
14 conditions that he has proposed that this supplemental
15 rebuttal testimony goes to is a 10% additional payment,
16 and this discussion you're talking about now is part of
17 my discussion about that. This would -- this is a
18 payment in his framework that would be above the levels
19 of forecasted imputation. And when he justifies it, he
20 says the company may have engaged in let me say bad
21 acts. You can read what he said. And therefore, the
22 Commission is -- and has raised risk, and therefore the
23 Commission is justified in imposing this additional 10%
24 penalty. And so I say, my words, it is as if that is a
25 prudence review which says the conduct of QCII

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1 management has -- was -- constituted bad acts, was
2 imprudent, and therefore an additional penalty of 10%
3 should be imposed upon the transaction at issue here.

4 COMMISSIONER HEMSTAD: Thank you, that's all
5 I have.

6 COMMISSIONER OSHIE: I don't have any
7 questions, thank you.

8 CHAIRWOMAN SHOWALTER: I have two follow-up
9 questions just on that last exchange.

10

11 E X A M I N A T I O N

12 BY CHAIRWOMAN SHOWALTER:

13 Q. What if you take penalties and fault and
14 imprudence out of it and you just say, the cause for the
15 need for the sale is due to the non-regulated parts of
16 the company and just -- and recognition of a sharing of
17 responsibility, 10% is reasonable. Do you find that to
18 be improper?

19 A. I do, and let me say something about that.
20 And something I, you know, sort of go after Dr. Blackmon
21 about is it's important, and I do use the word it's
22 important in my testimony, I'm not doing that without
23 thinking, it's important that when the government has
24 the ability to affect a, you know, the ownership of
25 people's assets that there be sound reasons for doing

0798

1 so. And in regulatory policy, we have rules and
2 procedures for doing that.

3 In this particular context, it is a kind of
4 potential in the way it's been recommended to you,
5 short-sighted view of the nature of risk in companies
6 like QC where -- you see if you're part of a -- if
7 you're part of a larger portfolio of different assets, I
8 know you get -- you all get testimony a lot from people
9 who talk about risk, you understand that there are
10 so-called portfolio effects of risk, and one of the
11 aspects of portfolio effects of risk is it means that
12 when one asset is doing well, another one is not doing
13 so well, and you get your risk reductions in the
14 overcall cost capital by the ability of that portfolio
15 to do that.

16 So if you take a slice in time and you say
17 this asset here isn't doing well and so therefore we're
18 going to penalize it, you're creating a potential
19 precedent in the capital markets in which, wait a
20 minute, at other times in the future it flips in the
21 other way. That's the nature of a portfolio, and you
22 would be happy that you were part of a portfolio,
23 because over time it holds your overall costs of capital
24 down.

25 And that's how I closed this last statement

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1 is I say there's a potential bad precedent for rate
2 payers, the cost of capital, and ultimately the sort of
3 business environment in the state of Washington. So I
4 don't mean to, you know, I don't want to -- you can see
5 I'm passionate about this because I think it's very
6 important for public policy to have a long-term view in
7 a situation like this where it's very easy to sort of
8 myopically say, oh, we're in a bad situation, we're
9 going to nail them now. But wait a minute, you would
10 like having this portfolio in the long term.

11 Q. So you're saying we should not take a
12 backward look, it is a little bit analogous to our
13 imprudence proceedings where we try to put ourselves
14 back in the shoes of the people who made a decision at
15 the time when they didn't know how it all played out.

16 A. Actually --

17 Q. So you're saying that it probably wasn't a
18 bad idea to do the merger, it just turns out in
19 retrospect it didn't work out right. But it doesn't
20 necessarily mean it was the wrong decision or couldn't
21 have provided benefits had either things or management
22 played out differently?

23 A. That's right. And I would say also just to
24 be clear, I think that, you know, I think that it is
25 appropriate for commissions such as this to engage in

0800

1 prudence reviews and not give them, you know, returns
2 that are the result of imprudent decisions. But as you
3 say, at the time you're doing a merger, people who are
4 risking their money are trying to presumably make the
5 best decisions they can.

6 Q. Okay, the other follow up I had was you said
7 something to the effect that something has value that
8 exceeds the Washington state portion of the sale. I
9 wasn't sure what you said and if there is a place in
10 your testimony where you say it where you could point me
11 to it.

12 A. It's not said here, it was in response to
13 another question that you asked. What can I say --

14 Q. Well, first of all --

15 A. Well, I can say --

16 Q. -- what is it that you said exceeded the
17 value?

18 A. The \$1.2 Billion present value.

19 Q. Exceeds?

20 A. Of the settlement. Assuming, I said, that I
21 understood Mr. Mabey correctly, that it would remove
22 business risks and would trump bankruptcy. He used the
23 word trump.

24 Q. Okay, that \$1.2 Billion exceeds something.

25 A. Exceeds, without naming a number, it exceeds

0801

1 what I understand to be the Staff's statement as to the
2 Washington state share of what the Staff calls the gain
3 from the sale. I almost said the number, I will stop
4 there.

5 Q. You don't need to say the number. Can you
6 point me readily --

7 A. Yes, if you look --

8 Q. -- to where that number is?

9 A. If you look in the exhibits to Dr. Blackmon's
10 testimony on the settlement, a yellow page, I think it's
11 GB-2C.

12 Q. 4C?

13 A. 4C, is it 4?

14 CHAIRWOMAN SHOWALTER: What exhibit is it?

15 JUDGE MOSS: 422C.

16 CHAIRWOMAN SHOWALTER: So it's Exhibit 422C,
17 the page labeled GB-4C or maybe that's the whole thing.

18 JUDGE MOSS: That's it.

19 CHAIRWOMAN SHOWALTER: That's it, all right.

20 BY CHAIRWOMAN SHOWALTER:

21 Q. So that comparison depends on your assessment
22 of the \$1.2 Billion --

23 A. That's correct.

24 Q. -- and Dr. Blackmon's and Dr. Selwyn's
25 assessment of another figure?

0803

1 economics and policy arises in at least two key ways.
2 One we're all familiar with, when you're setting your
3 rates for individual services, hookups, et cetera,
4 access charges and so forth, you concern yourself with
5 the, you know, long-run incremental cost, these kinds of
6 criteria in trying to determine whether or not a
7 particular service is being provided as a subsidy. But
8 at yet another level our public policy says
9 appropriately that privately owned businesses, regulated
10 businesses, should be able to support themselves. We
11 don't take, for example, support for lower rates to the
12 point of dipping in in some massive way to the treasury,
13 the tax rates of the state or federal government, and
14 pushing rates down to zero, we don't do that. We try to
15 set rates which recover costs.

16 The reason we do that is because this
17 particular industry, telecommunications, is actually
18 competing for the consumer dollar with all kinds of
19 other industries, clothing, food, groceries, whatever.
20 And so we have a public policy that says it's
21 appropriate for the services sold by that sector to
22 cover the costs of that sector, which you have with
23 imputation, and I say it was appropriate at the time of
24 transition. The imputation has the impact of taking
25 revenues from the sale of something else, Yellow Pages

0804

1 advertising, and using it to support the industry.

2 I think it was appropriate as a transition
3 mechanism, I have been as blunt as I can be, I think
4 it's in the long-run interest of the State of Washington
5 and the long-run interest of the rate payers to put this
6 industry in a position and have that go away, and the
7 settlement would do it in 15 years. But that's where --
8 that's what I'm talking about here.

9 Q. I understand. So I take it you just
10 emphatically disagree with Dr. Selwyn's latest response
11 on that issue about the impact of the revenue credits on
12 competition?

13 A. If I know what you're talking about,
14 Dr. Selwyn talks about in his view he uses the phrase
15 that the Yellow Pages business derives "massive economic
16 benefits" from the fact that we have a
17 telecommunications network out there.

18 Q. Well, and I think he also talks about its
19 impact on other above cost services?

20 A. Yes, I think that's -- I think that's not
21 accurate. I think it is appropriate for this Commission
22 to be trying to level that playing field. And if some
23 other rate is itself discouraging, for example, entry or
24 new competition, that -- and that rate is not set
25 according to sound economic policy, you should -- you

0805

1 appropriately, you spend your lives trying to work on
2 those problems, and I think that's appropriate.

3 COMMISSIONER HEMSTAD: That's all I have,
4 thank you.

5 JUDGE MOSS: Okay. Well, if there's nothing
6 further from the Bench, we may have some brief follow up
7 from Staff before we turn back to Mr. Harlow for any
8 redirect.

9 MR. TRAUTMAN: We do, Your Honor, thank you.

10

11 R E C R O S S - E X A M I N A T I O N

12 BY MR. TRAUTMAN:

13 Q. Mr. Kalt, what discount rate did you use to
14 arrive at your figure of \$1.2 Billion?

15 A. It's the current 20 year T-Bill. I think
16 it's about 4.9, something like that.

17 Q. Is this the same discount rate that the buyer
18 and seller used in their MRI, material regulatory impact
19 provision, in their own contract?

20 A. I don't think so, and you wouldn't expect
21 them to. They're measuring different risks.

22 Q. Now assuming, as you have stated, that the
23 revenue -- the present value amount of the settlement is
24 worth \$1.2 Billion, in that event, shouldn't Qwest be
25 indifferent as to a requirement for a one time up front

0806

1 payment of \$1.2 Billion versus the 15 year revenue
2 credit?

3 A. I don't believe that would be accurate, no.

4 Q. Could you explain why?

5 A. They would be better able to talk about their
6 concerns, but as we know, given their financial
7 conditions, they have a desire to have cash earlier
8 rather than late, and that's well known. But they're
9 better -- in a better position to talk about their
10 concerns in that regard.

11 I should also add just to make it clear and
12 also in response to Chairwoman Showalter's questions,
13 the \$1.2 Billion is a measure of the value to the rate
14 payers, to the rate payers. That is, they're the ones
15 in the position potentially to receive those set of
16 revenue credits.

17 Q. Do you think that the buyer would be willing
18 to increase its purchase price by \$1.2 Billion if Qwest
19 would agree to pay the buyer \$103 Million to \$110
20 Million per year for 15 years?

21 A. I would suspect, again going back to our
22 discussions of risk, it sounds like just a business
23 contract you mean? It doesn't have the force of the
24 Commission, a rate order of the Commission behind it?

25 Q. It did have --

0807

1 A. It doesn't have as much certainty?

2 Q. -- a rate order from the Commission.

3 MR. HARLOW: Objection, Your Honor --

4 A. I don't know if they could do that.

5 MR. HARLOW: I don't --

6 JUDGE MOSS: Okay, wait, wait, wait, we've
7 got to have one person talking at a time. The court
8 reporter can not possibly contend with more than one
9 person talking at a time, so let's just slow down.

10 Do you have an objection?

11 MR. HARLOW: Yes, I think the hypothetical
12 has no -- it doesn't make any sense, Your Honor, that a
13 contractual agreement between two parties, one of which
14 is not regulated by the Commission, could be equated to
15 a rate order.

16 JUDGE MOSS: Okay, well, I don't hear an
17 evidentiary objection in there, Mr. Harlow, but rather a
18 speaking objection, and the witness can say whether he
19 can answer the question or not on the basis of whether
20 it makes any sense.

21 MR. HARLOW: Well, I --

22 JUDGE MOSS: So let's let the witness
23 respond.

24 A. As I started to say before my attorney
25 interrupted, it sounds like it requires some legal

0808

1 interpretation that I'm not qualified to provide, but I
2 can say based on what I understand Mr. Mabey to have
3 said that such a contract would not trump bankruptcy, to
4 use Mr. Mabey's term, trump, and therefore you would
5 expect that would not be an equivalent contract. It's
6 in the nature of a contract.

7 BY MR. TRAUTMAN:

8 Q. No, but the question I asked you was in the
9 nature of a rate order of the Commission, not a
10 contract.

11 A. I don't know whether you could do that.

12 MR. HARLOW: Objection, calls for
13 speculation.

14 A. I think that -- I would think that it would
15 not be of equivalent value to them from a business point
16 of view.

17 Q. Why not?

18 A. Unlike the point of view from the perspective
19 of the rate payers, which is what the \$1.2 Billion has
20 done, there isn't an analog as I think about your
21 hypothetical to finding yourself in year 12, 13, or 14
22 where you as a rate payer are perfectly happy you're not
23 getting the revenue credits, because competition has
24 entered the market, and your rates are already low
25 because you have new services and new competitors

0809

1 providing you those services. I can't think of an
2 analog in your hypothetical contract to that.

3 Q. Is it your understanding that the revenue
4 credit will be reported as a revenue on QC's financial
5 reports?

6 A. I don't know.

7 Q. And will the revenue credit be available to
8 pay interest to QC debt holders?

9 A. I believe in an economic sense it would not
10 be available since the intention, as I understand the
11 Staff's position and the nature of this revenue credit,
12 is it would be passed through to the customers' rates,
13 so in an economic sense it goes to lowering rates.

14 MR. TRAUTMAN: We would like to make one
15 record requisition for the workpapers that you used to
16 support the \$1.2 Billion present value computation, the
17 computation of the settlement amount.

18 THE WITNESS: Sure, I have no problem doing
19 that.

20 MR. HARLOW: No problem, Your Honor.

21 JUDGE MOSS: All right, we'll make that
22 Record Requisition 6.

23 And does that complete the examination,
24 Mr. Trautman?

25 MR. TRAUTMAN: It does, Your Honor, thank

0810

1 you.

2 JUDGE MOSS: All right, Mr. Harlow, if you
3 have finished taking notes on the record requisition,
4 you can do your redirect.

5 MR. HARLOW: Yes, this one is pretty easy
6 actually, Your Honor.

7

8 R E D I R E C T E X A M I N A T I O N

9 BY MR. HARLOW:

10 Q. Dr. Kalt, you're close to getting back to
11 Boston here I think. I just want to clarify a couple of
12 things. First of all, if you know, does the stipulation
13 specify an interest or discount rate?

14 A. Not for doing the calculation I did. I was
15 looking at it from the rate payers' point of view.

16 Q. Does the stipulation to your knowledge
17 contain a calculation of net present value?

18 A. I don't recall seeing one in there.

19 Q. You were asked by Chairwoman Showalter if the
20 effect of the settlement, proposed settlement, was to
21 eat into Qwest Corporation's profitability; do you
22 recall that?

23 A. Would you say that again.

24 Q. You were asked whether, by Chairwoman
25 Showalter, if the effect of the settlement agreement

0811

1 would be to eat into Qwest Corporation's profitability
2 in the future, future years; do you recall that?

3 A. Yes.

4 Q. Okay. And I believe you answered yes to
5 that.

6 A. Well, in the context of it. As I think about
7 that, it partly depends on what you're measuring
8 against.

9 Q. Right.

10 A. Relative to the Staff's recommendation of
11 imputation, it would eat into it less.

12 Q. Yeah, that actually anticipates my follow up,
13 which is have you made a comparison between the extent
14 to which the proposed settlement would eat into Qwest
15 Corporation's profitability and the extent to which the
16 Staff's proposed, see if I can get the right term,
17 contract payments would eat into Qwest Corporation's
18 future profitability?

19 A. Yes, I have.

20 Q. Could you please explain that calculation and
21 what you found?

22 A. Yes. You will recall in Dr. Blackmon's new
23 conditions that I'm responding to in my latest writing,
24 he proposes a annual contract payment from QCI to QC in
25 an amount equal to what he measures as or he asserts

0812

1 would be the imputation based on some business documents
2 that he had. He also says that this contract would be
3 modifiable only by the Commission and would not be
4 modified by any change in the relationship between QCI
5 and QC, which I understood him to mean it would be
6 protected from bankruptcy. In other words, he was
7 trying to make sure that he proposed something that
8 would be protected from bankruptcy. Whether or not that
9 kind of contract could be protected from bankruptcy, if
10 it were, and it was treated say as a revenue credit.

11 And I treat -- I do the same thing, I take
12 the net present value using the 20 year T-Bill rate.
13 You find that from the net present value of that stream,
14 which is now away from business risk, it's not dependent
15 on costs and revenues, it's just something like a
16 revenue credit like we talked, that would have a net
17 present value of approximately \$3 Billion, which would
18 be about double what the Staff says is the imputation
19 value. But they're using the wrong interest rate when
20 they apply it to Dr. Blackmon's proposed contract.

21 Q. What's your understanding as to what the
22 Staff bases their proposed annual contract payment on?

23 A. It's based on some discovery documents in
24 which there were forecasts made for some number of years
25 of an imputation amount, essentially net cash flows.

0813

1 Then it was extrapolated, it only went out, I can't
2 remember, like 10 years or so. Another 30 or 40 years
3 extrapolated at a fixed growth rate, 2.1%.

4 Q. Do you have any opinion as to the
5 appropriateness of that methodology that the Staff
6 employed?

7 A. As I discussed in my latest written
8 submission, I think it's inappropriate. It is taking
9 business forecasts and turning them into certain
10 contract payments under that proposal. And if there's
11 anything we know, it's that if anyone says they know
12 what imputation will be 38 years from now, that doesn't
13 make sense. It just doesn't make sense because of
14 uncertainty.

15 Q. Do you think maybe Qwest International had
16 different forecasts at the time of the merger about its
17 future profitability than turned out to be the case?

18 A. At the time of what?

19 Q. I will withdraw that, it's leading anyway.

20 If you would please turn to Exhibit 264 at
21 page 4, lines 3 to 5.

22 A. Page 5?

23 Q. Page 4.

24 A. 4.

25 Q. Of Exhibit 264, your supplemental testimony.

0814

1 A. Yes.

2 Q. And you were asked a question with regard to
3 lines 3 to 5 by Mr. Trautman, and he asked you if you
4 were saying something or other, and I confess I didn't
5 get the question of what you were saying. And you said,
6 no, that's not what you were saying. Do you recall
7 that?

8 A. Yes.

9 Q. Okay. So what I would like to --

10 A. I can't remember what he asked me, I recall
11 the answer.

12 Q. So what I would like to do is flip that
13 around, because he didn't ask the follow up, and I would
14 like to ask the follow up. What is it you were trying
15 to say and intending about that particular sentence?

16 A. I go on and explain it in the next paragraph.
17 You hear it in, for example, Mr. Kennard's language,
18 they talk, these investment guys, they talk about the
19 quality of earnings and so forth. One dimension of
20 quality is how predictable are they. And the point I'm
21 trying to make here is that, number one, lower quality,
22 all else equal, shows up as lower multiples, and number
23 two, one dimension of lower quality is if I'm trying to
24 look out 38 years, that piece of information is going to
25 be lower quality than looking tomorrow or one year from

0815

1 now is just what that sentence refers to.

2 Q. Thank you. You were being questioned by
3 Commissioner Hemstad, and the Commissioner asked you if
4 Yellow Pages was a highly profitable business and
5 whether that was on a sustained and continuing basis; do
6 you recall that line?

7 A. Yes.

8 Q. Is that sustained and continuing high
9 profitability certain to continue in your opinion?

10 A. No. There are -- there are risks,
11 technological change, entry from competitors, changes in
12 the demographics, some of the things I talk about in my
13 report. Of course there are risks.

14 Q. All right. And how do such risks then play
15 out in the process such as what Qwest engaged in to sell
16 the Dex business ultimately to Dex Holdings?

17 A. All else equal, greater risk for any given
18 forecast around -- risk is sort of around a forecast,
19 greater levels of risk will cause bidders to bid less
20 for the ownership of the chance to own that forecast,
21 that is to have the chance to own the instrument, so
22 greater risk reduces values.

23 MR. HARLOW: Thank you very much, Dr. Kalt,
24 that's all the redirect I have.

25 JUDGE MOSS: Does that conclude our

0816

1 questioning?

2 MR. TRAUTMAN: Yeah, Your Honor.

3 JUDGE MOSS: All right, well, Professor Kalt,
4 we appreciate you being with us, and I hope you feel
5 better, and have a pleasant trip back to Boston.

6 THE WITNESS: Thank you very much.

7 JUDGE MOSS: We have Dr. Selwyn as our next
8 witness, and I think we probably need to have our
9 afternoon break before we put him on the stand, so
10 perhaps he can get organized at the stand during the
11 break. We will be in recess for 15 minutes, about 25
12 after the hour.

13 (Recess taken.)

14 JUDGE MOSS: All right, Dr. Selwyn, if you
15 will please rise and raise your right hand.

16

17 Whereupon,

18 LEE L. SELWYN,
19 having been first duly sworn, was called as a witness
20 herein and was examined and testified as follows:

21

22 JUDGE MOSS: Mr. Trautman, go ahead.

23 MR. TRAUTMAN: Thank you.

24

25

0817

1 D I R E C T E X A M I N A T I O N

2 BY MR. TRAUTMAN:

3 Q. Good afternoon, Dr. Selwyn.

4 A. Good afternoon.

5 Q. Could you please give your name and business
6 address for the record.

7 A. Yes, my name is Lee L. Selwyn. My business
8 address is Two Center Plaza, Suite 400, Boston,
9 Massachusetts 02108.

10 Q. Have you prepared for today the exhibits that
11 have been pre-marked as Exhibit 311T, your direct
12 testimony, Exhibits 312 through 334C, and Exhibit 363T,
13 which is your testimony pertaining to the settlement?

14 A. Yes, well, I believe that the testimony, both
15 the testimony, particularly 363, should have a TC after
16 it since it has confidential information in it.

17 Q. And were these exhibits all prepared by you
18 or under your supervision?

19 A. Yes, they were.

20 Q. Do you have any corrections to make?

21 A. I have several minor corrections that are
22 non-substantive.

23 In Exhibit Attachment 4, which I guess is
24 going to be --

25 JUDGE MOSS: What was previously identified

0818

1 as LLS-4C?

2 THE WITNESS: I believe so, yes, 4C.

3 JUDGE MOSS: Okay, that would be Exhibit
4 314C.

5 A. There are several tables in that attachment.
6 On the table marked Table 4, the title of the table that
7 is shown there says Qwest Dex Holdings, Inc., and the
8 word Holdings should be stricken, so it just reads Qwest
9 Dex, Inc.

10 And on Table 5, the column heading under B
11 that says total QC equity should be revised to say total
12 equity, total QC equity and liabilities, and column D
13 should be revised to say return on QC equity and
14 liabilities.

15 COMMISSIONER HEMSTAD: I'm sorry, was that
16 column D?

17 THE WITNESS: Column D, yes.

18 COMMISSIONER HEMSTAD: And it should read
19 what?

20 THE WITNESS: I'm sorry, return on, actually
21 return on QC liabilities and equity just to put it in
22 the same sequence.

23 BY MR. TRAUTMAN:

24 Q. And do you have any changes to make to your
25 testimony?

0819

1 A. Yes. In Exhibit 363TC, the supplemental
2 testimony, at page 11 on line 12, the word competition
3 should be changed to consumption. So the line should
4 now read, consumer benefit in the form of lower prices
5 and increased consumption.

6 Those are the only changes that I'm aware of.

7 Q. With those corrections, are these exhibits
8 all true and correct to the best of your knowledge?

9 A. Yes, they are.

10 MR. TRAUTMAN: Your Honor, I would move for
11 the admission of Exhibits 311T through 334C and 363TC.

12 MS. ANDERL: No objection.

13 JUDGE MOSS: All right, there being no
14 objection, those will be admitted as marked.

15 MR. TRAUTMAN: And Dr. Selwyn is available
16 for cross.

17 JUDGE MOSS: Ms. Anderl.

18 MS. ANDERL: Thank you, Your Honor.

19

20 C R O S S - E X A M I N A T I O N

21 BY MS. ANDERL:

22 Q. Good afternoon, Dr. Selwyn.

23 A. Good afternoon.

24 Q. I'm Lisa Anderl, I represent Qwest in this
25 matter.

0820

1 Dr. Selwyn, you're appearing here as an
2 expert witness on behalf of Commission Staff; is that
3 correct?

4 A. That's correct.

5 Q. Can you briefly describe for me what
6 Commission Staff asked you to do for Staff in this case?

7 A. I would refer you to, Ms. Anderl, to the
8 response to essentially the same question beginning at
9 page 4 of Exhibit 311T at line 6.

10 Q. And is that essentially then the limitations
11 on the scope of your undertaking and the scope of your
12 testimony in this proceeding?

13 A. Well, that's only as it started. Obviously I
14 was subsequently asked to review the company's rebuttal
15 testimony, to assist Staff counsel with
16 cross-examination, and to prepare the supplemental
17 testimony responding to the proposed settlement.

18 Q. Were you retained by Staff to prepare a
19 single point estimate of the fair market value of the
20 Dex properties?

21 A. No.

22 Q. Were you retained by Staff to prepare a range
23 of estimates of the fair market value for the Dex
24 properties?

25 A. No. I was -- I made no independent estimate

0821

1 of the value of the Dex properties and but instead
2 relied on estimates that were provided by the financial
3 advisors and management of the -- of Qwest and of the
4 buyer.

5 Q. Dr. Selwyn, are you an economist?

6 A. I am.

7 Q. Are you an investment banker?

8 A. No, I am not.

9 Q. Have you ever worked as an investment banker?

10 A. No, I have not.

11 In your direct testimony, Exhibit 311, on
12 page 7, line 17, you discuss a, and you probably don't
13 need to refer to that for purposes of this question, you
14 discuss a QCII bankruptcy. Are you providing testimony
15 here as a bankruptcy expert, or are you relying on
16 Dr. Blackmon's testimony in that discussion?

17 A. In this discussion, as it indicates, I'm
18 referencing Dr. Blackmon's testimony.

19 Q. Are you appearing here today as a bankruptcy
20 expert?

21 A. I'm not appearing as a bankruptcy expert. I
22 obviously have some general knowledge about bankruptcy
23 and have incorporated that general knowledge into my
24 testimony in evaluating various assertions being made by
25 the parties in the proceeding.

0822

1 Q. Are you an attorney?

2 A. No, I am not.

3 Q. Have you ever been a trustee in a bankruptcy
4 proceeding?

5 A. No, I have not.

6 Q. Have you written any papers with regard to
7 bankruptcy?

8 A. No.

9 Q. Are you a member of any associations or other
10 organizations that have bankruptcy as their specialty?

11 A. No.

12 Q. Dr. Selwyn, in your testimony that we just
13 referred to, page 7, line 20 through page 8, line 4, you
14 claim that rate payers receive no benefit from the
15 avoidance of bankruptcy. Is that a fair summary of your
16 testimony?

17 A. Again, I am relying on the testimony of
18 Dr. Blackmon for that opinion, but that is what my
19 testimony says, with the caveat that continues on in
20 that sentence.

21 Q. Do you understand that Qwest in its direct
22 testimony and in its settlement testimony is proposing a
23 sharing of the gain between shareholders and rate
24 payers?

25 CHAIRWOMAN SHOWALTER: Ms. Anderl, can I ask

0823

1 you to slow down your questions too.

2 MS. ANDERL: Yes.

3 CHAIRWOMAN SHOWALTER: Thanks.

4 A. No, I believe that Qwest is proposing to
5 capture a portion of the gain for itself and actually
6 reduce the amount of the value of the present imputation
7 arrangements to which rate payers would be entitled,
8 making -- providing rate payers with less in terms of
9 economic value than they have under the present
10 situation.

11 BY MS. ANDERL:

12 Q. Do you understand the terms of the settlement
13 to include a provision for a \$67 Million one time up
14 front bill credit?

15 A. Yes.

16 Q. Do you understand the other terms of the
17 settlement to include provision for revenue credits in
18 the amount of \$110 Million for the first four years and
19 \$103.4 Million for the next 11 years for a total of 15
20 years of annual revenue credits?

21 A. That's what the words say. I don't know what
22 the actual value of that is, if any.

23 Q. Okay. Dr. Selwyn, assume with me as a
24 hypothetical that a Qwest bankruptcy is imminent without
25 the sale of Dex and that the Commission risks losing

0824

1 control over the sale and the disposition of the gain in
2 that bankruptcy. Do you have that assumption in mind?

3 A. Yes.

4 Q. Would you still recommend that the Commission
5 deny the sale?

6 A. Yes.

7 Q. And under those circumstances, do you have
8 any understanding of what rate payers might receive from
9 the sale transaction?

10 A. Well, it's my understanding that the
11 Commission has standing in a bankruptcy proceeding to
12 address before the bankruptcy court rate impacting
13 effects of the bankruptcy action. To the extent that
14 the bankruptcy were to have a rate impact, which it
15 would if, for example, the imputation or credit or any
16 other manner in which the benefits of the publishing
17 business were denied to rate payers, notwithstanding
18 this Commission's determination that those, in fact,
19 were rate pay or regulatory assets of QC, I believe that
20 the Commission would have -- it's my understanding that
21 the Commission would have standing to address these
22 issues in the bankruptcy proceeding and that, I believe
23 as Mr. Mabey himself testified earlier today, that the
24 bankruptcy court would give weight to the rate impact of
25 the reorganization that might be proposed.

0825

1 In as much as I consider the revenue credit
2 to be of questionable -- as proposed in the settlement
3 specifically to be of questionable value because of,
4 among other things, the potential for a QCII bankruptcy
5 several years down the road in the event that the sale
6 at this point is consummated, a potential sale of QC to
7 a third party who I don't see any mechanism by which
8 that third party could be bound by any such revenue
9 credit commitment as a -- if not as a legal matter,
10 certainly as a financial matter. I just don't -- and
11 reflecting the assessment of the risk of bankruptcy that
12 Dr. Blackmon has offered, I do not believe that
13 bankruptcy of -- that the Commission should accede to
14 the pressure being imposed on it by the company to
15 approve this transaction.

16 Q. Dr. Selwyn, would you accept subject to your
17 check that in the last rate case the imputation
18 adjustment was approximately \$85 Million?

19 A. I believe that's correct.

20 Q. Now do you -- and the revenue credit that's
21 proposed in the stipulation and settlement is higher
22 than that; is that right?

23 A. It's higher than that because the earnings of
24 Qwest Dex have increased, and were there a rate case, it
25 would similarly be higher, so it's only import of the

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1 increase is in the event of a rate case during the time
2 frame in which the revenue credit is in effect. So its
3 impact is essentially assuming that the revenue credit
4 has the same regulatory effect as imputation, which I,
5 as I had indicated in my supplemental testimony, I do
6 not believe to be the case, but assuming that to be the
7 case, then it would be essentially the equivalent of the
8 imputation in the initial year. The imputation,
9 however, would be increasing, whereas the revenue credit
10 is actually decreasing. So beyond the initial year,
11 there would be a divergence of the imputation amount and
12 the revenue credit.

13 Q. Dr. Selwyn, I would like you to kind of try
14 to assume with me two parallel scenarios. One is where
15 we are today with \$85 Million last ordered in a rate
16 order in imputation, and QCII and QC and Dex go into
17 bankruptcy. Dex is sold, and the proceeds distributed
18 to creditors, and the bankruptcy court does not impact
19 the \$85 Million in imputation because it is a rate
20 order. Do you have that one assumption in mind?

21 A. Yes.

22 Q. And then the other assumption that the
23 Commission permits Qwest to sell Dex under the terms of
24 the stipulation, \$67 Million is distributed to rate
25 payers, and the company subsequently goes into

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1 bankruptcy, and the bankruptcy court then similarly
2 decides that the stipulation and settlement is a rate
3 order and that it can not impact the \$110 Million
4 revenue credit. Do you have both of those scenarios in
5 mind?

6 A. I have them in mind. I'm not sure they
7 completely describe either situation, but.

8 Q. That's fine, Dr. Selwyn, I'm sure that
9 Mr. Trautman can help you clarify that on redirect.

10 In both scenarios, the ending point is that
11 the Dex properties are sold; isn't that right?

12 A. Perhaps.

13 Q. Those were the scenarios that I gave you
14 though, aren't they?

15 A. Oh, then they speak for themselves.

16 Q. And in the scenario where the Dex property is
17 sold through bankruptcy, you have no direct knowledge
18 that rate payers would get any sort of a bill credit, do
19 you?

20 A. This is your first case?

21 Q. That's correct.

22 A. I suppose not.

23 Q. But in the second case, if Dex were sold
24 prior to the bankruptcy and the bill credit had already
25 been distributed, rate payers would have received that

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1 \$67 Million benefit; isn't that right?

2 A. I suppose.

3 Q. Dr. Selwyn, have you ever been employed as a
4 business valuation expert by the buyer of a business?

5 A. I'm trying to recall whether I have ever done
6 something like that. I have certainly been involved in
7 things like damages assessments but probably not,
8 certainly not of anything of the magnitude that we're
9 talking about.

10 Q. Have you ever been employed as a business
11 valuation expert by a seller of a business?

12 A. No.

13 Q. Dr. Selwyn, you filed two pieces of testimony
14 in this matter, and the first one is quite lengthy, I
15 think about 110 pages. Did you find that in that
16 testimony you were able to set forth for the
17 Commission's consideration all of the things that you
18 believe are important for the Commission to take into
19 consideration in this case?

20 A. I have tried.

21 Q. Let's look at your testimony, Dr. Selwyn, at
22 the bottom of page 91, top of page 92, this is Exhibit
23 311. You describe there a complaint filed by National
24 Management Services or NMS; is that correct?

25 A. Yes.

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1 Q. Is the purpose of that testimony to
2 illustrate your contention that Dex has little or no
3 good will of its own?

4 A. Well, as I say, as I state at on page 91 at
5 line 19, the evidence shows that Dex has run its
6 operations as a monopoly with little attention to good
7 vendor or customer relations. It's simply to
8 demonstrate that as between and to respond to the
9 contention that relationship between Dex employees and
10 Dex customers was a -- represented a valuable component
11 of a or a component of the value of Dex, it was to
12 indicate simply that there is evidence that Dex is
13 operating primarily as a monopolist deriving that status
14 from its affiliation with QC and that it is not treating
15 its customers in a way that one might expect firms that
16 were concerned about competitive losses to behave.

17 Q. Is NMS a customer of Qwest Dex?

18 A. No, it's an agent of Qwest Dex.

19 Q. It's a seller of Yellow Pages advertising,
20 isn't it?

21 A. Correct.

22 Q. Is it your opinion, Dr. Selwyn, that the
23 existence of a complaint by an agent or competitor is
24 evidence of a lack of good will in a business?

25 A. Well, it depends on how frequently those

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1 complaints occur.

2 Q. Do businesses with good will -- well, is it a
3 requirement for a business to have no complaints at all
4 before it could have any good will?

5 A. No.

6 Q. Now on this NMS complaint, did you research
7 that issue yourself, or did you have someone do it for
8 you?

9 A. It was done by a member of my staff.

10 Q. Did you ask that staff member to procure all
11 of the judicial history of that case for you?

12 A. I don't recall.

13 Q. What did you ask your staff member to get for
14 you with regard to that case?

15 A. I believe the review was pretty much confined
16 to information that was provided to us.

17 Q. You state in your testimony that the case is
18 now on appeal to the Ninth Circuit; is that right?

19 A. That's my understanding.

20 Q. How do you know that?

21 A. That was the information that was provided to
22 me by the member of my staff who did the research.

23 Q. Did you review the judgment that's on appeal
24 to the Ninth Circuit?

25 A. No.

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1 Q. The complaint, did you review the complaint?

2 You attached that as an exhibit to your testimony.

3 A. Yes.

4 Q. The complaint contained a breach of contract
5 claim, did it not?

6 A. Yes.

7 Q. And it contained a claim for the breach of
8 the implied covenant of good faith and fair dealing?

9 A. That's my recollection.

10 Q. Okay.

11 A. I didn't memorize it.

12 Q. The Federal District Court judge in that case
13 granted Dex's motion for summary judgment on both of
14 those claims?

15 A. I believe so.

16 Q. Do you understand what a summary judgment
17 means?

18 A. Yes.

19 Q. You didn't put that information in your
20 testimony, did you?

21 A. Apparently not.

22 Q. Did you believe that the filing of the
23 complaint was an important consideration for the
24 Commission in this case?

25 A. Well, you know, there were -- there were

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1 several corroborating pieces of evidence that we
2 examined, several of which are included in my attachment
3 that --

4 Q. Yes, Dr. Selwyn.

5 A. -- go to the issue. And so I was not
6 attempting to suggest to the Commission that the
7 evidence of any one single event, and I don't know that
8 by any means that this is an -- provides any exhaustive
9 list and don't represent it as providing an exhaustive
10 list of all such complaints. These were provided simply
11 as examples.

12 Q. You thought that the filing of the complaint
13 though was important enough to call to the Commission's
14 attention in this case?

15 A. Yes, yes.

16 Q. And you also thought that the fact that the
17 complaint was on appeal to the Ninth Circuit was
18 important?

19 A. Only to inform the Commission that the matter
20 hadn't been resolved.

21 Q. Did you think that the judge's ruling on the
22 complaint was important?

23 A. Well, certainly it was important.

24 Q. But you didn't put that in your testimony?

25 A. No, I didn't.

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1 Q. Dr. Selwyn, you also discussed the
2 advertising defector tracking study which is in your
3 testimony at page 92.

4 A. Right.

5 Q. And contained -- the study itself is
6 contained in your exhibits as Exhibit 332C. I don't
7 think you need to look at it for purposes of these
8 questions, but --

9 A. Well, let me get it out anyway. That would
10 be Attachment 22 I think.

11 Q. Yes, that's right.

12 A. Okay.

13 Q. Is the purpose of the testimony describing
14 the advertising defector tracking study to support your
15 contention that Dex has little or no good will of its
16 own that is being transferred in this transaction?

17 COMMISSIONER HEMSTAD: Counsel, may I ask
18 what page of the testimony are you in?

19 MS. ANDERL: I'm sorry, Your Honor, my notes
20 were wrong, it is at page 93, line 12.

21 A. That was certainly among the reasons it was
22 -- that I included it.

23 BY MS. ANDERL:

24 Q. Would you agree that Dex's good will, the
25 existence of Dex's good will or the lack thereof,

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1 depends on customer perceptions, at least to some
2 extent?

3 A. Among other things.

4 Q. And in order to assess customers'
5 perceptions, wouldn't you want to look at information
6 that provides a representative sample of customer
7 perceptions?

8 A. I'm not sure I understand the question.

9 Q. If you wanted to assess customer perceptions
10 about Dex, wouldn't you want to look at information that
11 provides a representative sample of customers and
12 customer perceptions?

13 A. As opposed to a sample of just customers who
14 defected; is that what you're getting at?

15 Q. Yes.

16 A. I might, but the defection study is what I
17 had available, and I felt it was still dispositive.

18 Q. So, Dr. Selwyn, as you have just noted, this
19 study was a defector tracking study. Is it your
20 understanding that this study assessed the opinions held
21 about Dex by current Dex advertisers?

22 A. No, it held the -- it was a study of
23 defectors.

24 Q. And subject to your check, isn't it correct
25 that page 1 of that study indicates that the primary

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1 purpose of this research is to understand why former Dex
2 customers stopped advertising with Dex?

3 A. Yeah.

4 Q. In your opinion, does a sample that is
5 limited to customers who have discontinued doing
6 business with Dex provide representative information
7 with regard to customers who continue to do business
8 with Dex?

9 A. Well, it can, and I certainly, you know,
10 think that in this case it did. For example, I was
11 particularly impressed by the relatively large number or
12 large percentage of respondents to the survey that
13 actually thought they were still customers and were
14 still advertising when, in fact, they apparently were
15 not, which suggests something to me about the way in
16 which Dex communicates with its customers.

17 I can tell you just from personal experience
18 in dealing with Yellow Page advertising many years ago,
19 many customers, many business customers may not know
20 exactly what Yellow Page advertising they are actually
21 doing, because they, you know, in many cases don't get
22 itemized statements that spell that out.

23 So what we were looking at here, people --
24 people advertise in the Yellow Pages because it's a way
25 of getting their business before the public and in an

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1 organized way. To the extent that they perceive the
2 Yellow Pages, the telephone company affiliated Yellow
3 Pages as the principal vehicle for doing that, they may
4 be confronted with little or no choice. The defector
5 study is obviously focusing on those customers who for
6 whatever reason felt that they weren't getting value or
7 were unaware that they weren't -- they were unaware that
8 they stopped advertising in the Yellow Pages.

9 Q. Dr. Selwyn, if you were to survey -- let's
10 leave that.

11 Let's talk a little bit about the business
12 enterprise value of Dex, and I believe that that would
13 be your testimony starting at about page 6 or 7, no,
14 sorry, starting on page 8, but I have some general
15 questions first. Can you describe for me what the
16 business enterprise value of a business is?

17 A. Well, the business enterprise value of the
18 business is generally looks at a business in terms of
19 its existence as a going concern on the assumption that
20 it remains intact in terms of all of its tangible and
21 intangible assets and continues in operation not with --
22 generally along without interruption in the event of a
23 sale. And generally it would be determined on the basis
24 of a present value analysis of future earnings that that
25 business is capable of producing. So it's the worth of

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1 the business as an economic entity in terms of the
2 profit that the business is capable of throwing off for
3 its owners over time.

4 Q. And what is the fair market value of a
5 business?

6 A. Fair market value of a business is what the
7 business can bring in an arm's length transaction in the
8 market under conditions where that fair market value or
9 where that transaction can be accomplished without any
10 unusual circumstance, such as, for example, a distress
11 sale. Now there will always be -- a transaction will
12 always take place, an arm's length transaction, at a
13 price that the buyer and seller agree upon, but whether
14 or not that constitutes the fair market value will
15 depend upon the market, the conditions extant to the
16 market at the time, the timing of the sale relative to
17 the business enterprise in terms of what the sale can
18 produce in the market relative to its business
19 enterprise value, the conditions under which the sale
20 was taking place, the conditions under which the buyer
21 may have been looking at alternatives, and a number of
22 other factors.

23 Q. Are the business enterprise value and fair
24 market value the same thing?

25 A. Well, they certainly can be as a theoretical

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1 matter. Generally if a transaction takes place at
2 business enterprise value and if both the buyer and
3 seller's perception of business enterprise value is the
4 same, which it by the way need not be, then I would -- I
5 would expect that the fair market value and business
6 enterprise value should bear a relatively close
7 relationship to one another.

8 Now where they begin to differ is, for
9 example, where the buyer's view of business enterprise
10 value and the seller's view of business enterprise value
11 differ. For example, the buyer may have certain
12 synergies that it believes it can exploit with other
13 assets that the buyer owns, in which case the buyer
14 might ascribe a larger business enterprise value to the
15 asset than the seller might ascribe, and that might be a
16 basis for a sale transaction to take place where we
17 would see the fair market value or the sale price, for
18 example, falling someplace between those two values.

19 Q. Do you think that estimates of the business
20 enterprise value or fair market value of a business are
21 the same thing as the actual business enterprise value
22 or fair market value?

23 A. Well, the actual business enterprise value is
24 something that can only be established with 20/20
25 hindsight once we know exactly what revenues, what

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1 earnings the business was able to generate over a period
2 of time. So by definition, if we're looking at a
3 business and attempting to value its future, we will
4 necessarily have to develop it on the basis of an
5 estimate. And obviously estimates can differ for a
6 variety of reasons, including the examples I gave a few
7 moments ago with respect to different expectations of a
8 buyer of a business, a proposed buyer of a business and
9 a seller of that business. There may be other
10 assessments that different analysts might establish with
11 respect to the impact of technology, the impact of
12 competition, the impact of market conditions, economic
13 conditions, and a variety of other things, so it would
14 typically be a range of business enterprise values that
15 different analysts would establish.

16 Q. And prior to actually determining the fair
17 market value of an asset in an arm's length transaction,
18 is it also true that the fair market value of an asset
19 or a business can be estimated?

20 A. Well, again, normally the fair market value
21 is --

22 Q. Dr. Selwyn, can you please answer yes or no
23 and then go ahead and explain.

24 A. Well, you can estimate anything, so
25 therefore, you know, an answer to that question is

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1 somewhat meaningless without an explanation. I mean you
2 can pick -- obviously you can estimate a fair market
3 value, you can estimate the height of this table, I mean
4 anything can be estimated. The question that's relevant
5 is how this is done and what its significance is, and
6 that's what I was attempting to respond to.

7 Q. Can a fair market value be established with
8 certainty as a single point absent the actual arm's
9 length transaction?

10 A. Well, an arm's length transaction certainly
11 provides a great deal of information about the fair
12 market value of the asset in question. But without
13 specific knowledge of the conditions associated with the
14 manner in which that transaction takes place, whether or
15 not that -- the mere fact that the transaction occurs is
16 not dispositive of whether or not we're dealing with
17 fair market value.

18 If, for example I'm trying to sell my house
19 and I really need cash and I've got to find somebody who
20 will make me a cash offer and is ready to close within
21 30 days, that's going to restrict my access to other
22 potential buyers who might be willing to pay more. So
23 if one were to use the value of the transaction that I
24 ultimately achieve under those circumstances, that would
25 certainly teach us something about the fair market value

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1 of the house, but it would not necessarily reflect what
2 might occur under conditions where I was prepared to
3 make an offering that would -- could be considered by a
4 broader spectrum of the market.

5 As I restrict my potential buyer base to a
6 narrower subset of the universe of buyers out there,
7 then I can reasonably expect that I will get less for
8 the property, and therefore I might, in fact, get less
9 than what I would consider its fair market value to be
10 were I not constraining the purchase.

11 Q. Is it your opinion that estimates are more
12 reliable than actual transactions in the marketplace in
13 terms of indicating value?

14 A. It can be, again supposing that -- let me go
15 back to my, you know, house examples. Posing that there
16 is a subdivision of 20 entirely identical houses so that
17 in theory they should all get the same value, but one
18 particular seller has the kind of constraints on the
19 transaction that I was describing a few moments ago but
20 that most other sellers in the market do not. What one
21 would do in that situation and to develop fair market
22 value is not just look to the one transaction but look
23 to comparables in the market, comparable transactions
24 for comparable properties, you know, and strike some
25 balance among the various transactions without relying

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1 on a single point.

2 And, you know, that -- I don't think that it
3 is correct to assume that a singular event involving a
4 single transaction is dispositive of what fair market
5 value is. In other words, that creates -- that converts
6 the concept into a totalogy. Fair market value is
7 whatever the transaction occurs at, and obviously the
8 transaction would always be done at fair market value,
9 and we know that is not always the case because
10 transactions may be constrained.

11 Q. If, for example, a seller has a business that
12 the seller believes is worth \$1 Million based on the
13 future expected stream of earnings and an auction is
14 held and the business is on the market for a sufficient
15 length of time with sufficient advertising so that a
16 substantial pool of interested buyers is made aware of
17 the offering, and the buyers of that pool of buyers,
18 none of them believes that the business enterprise value
19 is more than \$800,000, so 20% below the seller's
20 expectation. But the seller -- and the seller
21 nevertheless agrees to go ahead with the transaction,
22 not being constrained in any way, but believing that the
23 buyers have told him what the market is for his asset.
24 What's the business enterprise value of that business
25 after the sale is consummated at \$800,000?

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1 A. Well, first of all, your hypothetical is not
2 accurate, because if the transaction is by definition
3 constrained by factors that have to be considered. For
4 example, the availability of financing for the
5 transaction, if there are problems with respect to
6 financing, if the capital markets aren't forthcoming
7 with financing, then the price that buyers are prepared
8 to offer would be constrained by the availability of
9 financing. This is a point that Mr. Kennard made on
10 Monday, that there were limits to what could be financed
11 in the case of the sale of Dex that constrained the
12 price that buyers, specifically that the Dex Holdings
13 Group was prepared to make.

14 What we have to do is look at the transaction
15 in the broader context of other conditions in the
16 market, the state of the economy, the state of CAP, the
17 availability of capital, the availability of
18 alternatives at that particular point in time, how
19 critical it is to the seller to dispose of the property
20 at that point in time versus some other point in time,
21 or for that matter, to retain the asset without selling
22 it. So the notion that you can just, you know, pick a
23 given transaction, whether it be at auction or through a
24 brokerage sale or an advertised sale or whatever and
25 assume that the price that sells constitutes the fair

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1 market value is simply inaccurate.

2 Q. In the scenario that you described there was
3 simply no market for that business asking price of \$1
4 Million; is that what you're saying?

5 A. There may not have been. Even though buyers
6 might have been -- might have believed that it was worth
7 \$1 Million, if they weren't able to secure financing at
8 that price level for whatever reason, then they were --
9 would be unprepared to offer \$1 Million, and we can't
10 tell from the facts that you gave me in the hypothetical
11 what the source of the issue was.

12 It could also be, I suppose, that the -- that
13 the, you know, the buyer was in some state of denial, I
14 mean, I'm sorry, the seller was in some state of denial
15 as to what the business was actually worth and perhaps
16 thought it was worth more than it actually was. We just
17 don't know from the facts that you presented.

18 Q. Let's talk a little bit in general about
19 estimating a business enterprise value. Are you
20 prepared to discuss how a person might properly do that
21 in general terms?

22 A. Yes.

23 Q. I guess at the highest level, in order to do
24 so, would a person want to have accurate data?

25 A. Certainly.

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1 Q. Do you think that a business enterprise value
2 can be estimated from data that's inaccurate or out of
3 date?

4 A. Yes, if the data is interpreted and adjusted
5 for those types of infirmities.

6 Q. So it has to be made accurate, is that what
7 you're saying?

8 A. Well, it has to be -- or its inaccuracies,
9 the extent of its inaccuracies have to be, you know,
10 captured in some way, either in the form of adjustments,
11 extrapolations from past results that might shed some
12 light on the accuracy of the data, or increasing the
13 discount rate that's used in DCF analyses in order to
14 reflect the greater uncertainty associated with the
15 questionable data. I mean there are a variety of ways
16 one deals with it. One doesn't just, you know, throw up
17 his hands and forget it simply because the data isn't
18 precise.

19 Q. Does a valuation estimate in your view have
20 to be done roughly contemporaneously with the
21 transaction in order to be reliable?

22 A. Well, it can be reliable, although perhaps
23 not quite as reliable, depending upon its age. If I
24 look at the value of a piece of real estate that was
25 done three months ago, that's probably more liable in

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1 terms of representing its current value than one that
2 was done three years ago.

3 But on the other hand, if all I have is the
4 three year old result, if I know something about market
5 conditions, for example, about general price trends in
6 the market, I might actually be able to use that result
7 to develop a current value. I might look at what
8 properties sold for, comparable properties had been
9 selling for and changes in price trends in a particular
10 community, and I might then look at what the last sale
11 price was for the property and then make an
12 extrapolation.

13 So yes, I can derive reliable results with
14 varying degrees of reliability from whatever data that
15 I've got.

16 Q. Dr. Selwyn, on page 6 of your testimony at
17 lines 17 and 18, you state that:

18 Qwest's own financial advisors have each
19 estimated a higher business enterprise
20 value for Dex than the \$7.05 Billion
21 sale price.

22 Do you see that?

23 A. Yes.

24 Q. You refer to the estimates of Qwest's
25 financial advisors. Are those estimates included in

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1 your testimony, specifically the summary pages of the
2 Lehman Brothers at Exhibit 317 and the Merrill Lynch at
3 Exhibit 319?

4 A. I believe so. That would be Attachment 7 and
5 9.

6 Q. LLS-7 and 9, that's right. And those are
7 confidential documents. I think I can ask you about
8 them without needing to have a confidential record at
9 this point.

10 A. Yes.

11 Q. Look at Exhibit 317, please.
12 Lehman Brothers.

13 Is that one of the documents that you are
14 referring to when you state:

15 Qwest's own financial advisors have each
16 estimated a higher BEV for Dex than the
17 \$7.05 Billion in cash.

18 A. Yes.

19 Q. Is there a single business enterprise value
20 set forth on Exhibit 317?

21 A. No, there are ranges.

22 Q. Why don't you look with me at the first
23 valuation where it says on the far left, a comparable
24 transaction analysis.

25 A. Right.

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1 Q. Would you agree with me that it is only the
2 six valuations with the black bars on the left-hand side
3 of the page that are relevant to review because those
4 are the ones that review Dex as a stand alone?

5 A. Yes, well, I'm not sure the relevant -- no, I
6 wouldn't agree that that's necessarily relevant, because
7 I think that the other four are also relevant.

8 Q. The other four are also relevant?

9 A. The other four relate to the valuation
10 assuming that Dex remains part of Qwest. Clearly if I'm
11 looking at what I can sell the asset for, I'm also going
12 to be interested in what its value is if I don't sell
13 it.

14 Q. All right. The first valuation is presented
15 as a range; is that correct?

16 A. That is correct.

17 Q. And \$7.05 Billion falls within that range; is
18 that right?

19 A. That is correct.

20 Q. The second valuation is also presented as a
21 range.

22 A. That's correct.

23 Q. And \$7.05 Billion falls within that range?

24 A. Yes.

25 Q. The third valuation is also presented as a

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1 range; is that right?

2 A. That's correct.

3 Q. And \$7.05 Billion falls within that range?

4 A. Yes.

5 Q. The fourth valuation is also presented as a
6 range.

7 A. Same answer.

8 Q. The fifth valuation is a range wherein the
9 sale price is below the range?

10 A. That is correct.

11 Q. The sixth valuation is also presented as a
12 range, and 7.05 Billion falls within that range; is that
13 right?

14 A. That's right.

15 Q. Look at Exhibit 319 for me, if you would,
16 Dr. Selwyn. That's the Merrill Lynch valuation
17 analysis?

18 A. Yes.

19 Q. Containing the summaries of the Dex
20 valuation?

21 A. Yes.

22 CHAIRWOMAN SHOWALTER: Dr. Selwyn, can you
23 pull the microphone closer to you.

24 THE WITNESS: I'm sorry.

25 CHAIRWOMAN SHOWALTER: Thank you.

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1 BY MS. ANDERL:

2 Q. Is there a single business enterprise value
3 estimate set forth anywhere on that page?

4 A. No, there are six ranges or six sets of
5 ranges, and for two of the six, the value -- the top and
6 bottom of the range are above the 7.05, and for the
7 other four, the 7.05 is between the top and the bottom,
8 just to cut things short.

9 Q. When you state that Qwest's own financial
10 advisors have each estimated a higher BEV for Dex than
11 the \$7.05 Billion sale price, what business enterprise
12 value are you attributing to each of these advisors?

13 A. Well, because there were no probabilities or
14 weightings applied with respect to these ranges, I took
15 them to suggest an equal likelihood of falling anywhere
16 within the range, and therefore for that reason I felt
17 that in responding and addressing this and trying to
18 create some sort of composite view that use of the mid
19 pont was reasonable, and that's what I did.

20 Q. Did you talk to Merrill or Lehman about that?

21 A. No, I did not. But again, I didn't see any
22 indication in the -- in their report that would have
23 suggested that there were -- that there was any obvious
24 reason why that the one end of the range was being
25 suggested as carrying greater weight than the other end.

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1 Q. Do either of the analysts ever state anywhere
2 on these documents or on any of the other documents that
3 you reviewed that the mid point was the business
4 enterprise value?

5 A. No, and I'm not stating it either as such.
6 I'm trying to simply in my testimony, which as we have
7 discussed before, I was not engaged to and I did not
8 develop a business enterprise value for this transaction
9 or an estimate of the business enterprise value, but I'm
10 simply indicating that in looking at these exhibits, one
11 certainly can walk away with the view that the consensus
12 of the methodologies that were being used and the ranges
13 that were being provided was that the BEV was above
14 7.05. And, you know, if you would like me to modify my
15 testimony to describe it in that way, then I'm certainly
16 happy to do that, because that's certainly what I had in
17 mind.

18 Q. That it's your conclusion as opposed to the
19 analysts' conclusions?

20 A. No, that it's my conclusion that this is the
21 consensus of the analysts, that the business enterprise
22 value is greater than 7.05.

23 Q. Did you read the analysts' fairness opinions?

24 A. Yes.

25 Q. And, Dr. Selwyn, again on page 35 of your

0852

1 testimony, you ask yourself the question at line 11, you
2 say:

3 Dr. Selwyn, you have pointed out that
4 QCII's own financial advisors for the
5 Dex sale had found the enterprise value
6 of Dex to be significantly higher than
7 the sale price of \$7.05 Billion.

8 When you asked yourself that question and you
9 state that the financial advisors found the enterprise
10 value of Dex to be significantly higher than the sale
11 price, are you referring there to any single point
12 estimate of business enterprise value provided by any of
13 the analysts or advisors?

14 A. No, I'm not referring to any single point
15 estimate. I'm referring to that same consensus that we
16 were describing earlier.

17 Q. Look at Exhibit 320, please, which is your
18 LLS-10.

19 A. Yes.

20 Q. Now you have used a Bear Sterns presentation
21 from February of 2002; is that right?

22 A. Yes.

23 Q. The date of the sale transaction was August
24 19th, 2002; isn't that right?

25 A. Yes.

0853

1 Q. Did you do any investigation to ascertain
2 whether the data that supported the February
3 presentation was accurate as of August?

4 A. I want to be accurate about how this was
5 done, because the description that you gave was not
6 quite accurate. The methodology that was used in this
7 analysis was a replication of the Bear Sterns
8 methodology that is presented two pages later, but the
9 data that was used was from the Lehman Brothers
10 memorandum that begins on the following page that's
11 dated April.

12 Q. What investigation did you do to ascertain
13 whether the data from the April presentation was
14 accurate as of August?

15 A. I made no specific investigation.

16 Q. Let me just see if I understand your
17 testimony. Is it your testimony that the mid point of
18 all of the ranges presented by Lehman Brothers and
19 Merrill Lynch in the Exhibits 317 and 319 represents the
20 business enterprise value of Dex?

21 A. No, it's my testimony that from the -- from
22 those reports and those analyses, I conclude that the
23 consensus of the two advisors was that the business
24 enterprise value was above the 7.05 and by an amount
25 that I calculated based upon averaging the mid point

0854

1 values. And I would, you know, further note, and this
2 goes to the issue of the timing of this, that to the
3 extent that market conditions, for example, had
4 deteriorated between the winter and the summer as
5 Mr. Kennard suggested, that may well have also
6 influenced the reduction in the BEV between the earlier
7 estimates by the advisors and the later ones. But all
8 that does is demonstrate the critical nature of the
9 timing of the transaction, and it doesn't go to the fair
10 market value and certainly does not undermine my overall
11 conclusion that this was a distress sale. In fact, it
12 perhaps corroborates it.

13 Q. During August of 2002, Dr. Selwyn, is it your
14 testimony that anyone could have predicted accurately
15 whether the market was going to continue down or might
16 head back up?

17 A. Well, whatever was being predicted by the
18 market was reflected in prices and yields and returns
19 and the cost of debt in the financial markets. At any
20 point in time that -- whatever the current market level
21 is and whatever the interest rate and debt rates are
22 reflects what those values are.

23 Now we heard Mr. Kennard the other day saying
24 that the bond market, for example, in the summer of 2002
25 had become very distressed, and that was the condition

0855

1 as it existed. So if a transaction was going to take
2 place at a particular point in time when the capital
3 markets were in a very unstable state, then obviously
4 that had some effect. And so to the extent that that
5 may have been factored into these analyses, that may
6 explain the reduction.

7 I believe there was also an indication that
8 the revenue forecast had been, I think that was also
9 addressed I think in Mr. Kennard's testimony but it may
10 be in somebody else's, that the revenue forecast had
11 been revised downward several times again based on,
12 among other things, economic conditions, so further
13 underscoring the importance of the time of the
14 transaction.

15 Q. Dr. Selwyn, you indicated that you didn't
16 have any probabilities that would have enabled you to
17 weight the various valuation scenarios; is that correct?

18 A. That's my belief, yes.

19 Q. And based on that lack of information, on
20 what basis did you conclude that the mid point was the
21 most likely BEV as opposed to the low end of the range
22 being the most likely BEV if you didn't have any
23 information upon which you could weight those?

24 MR. TRAUTMAN: Objection, I'm not sure that
25 correctly characterizes the witness's testimony.

0856

1 JUDGE MOSS: Well, then the witness can
2 correctly characterize his testimony in his answer.

3 A. Since there was no indication that there was
4 any weighting, differential weighting assigned to
5 various portions of those ranges, if one assumes a
6 horizontal distribution, a uniform distribution of
7 outcomes within the range, then the mid point is the
8 maximum likelihood indicator, is the maximum likelihood
9 point of the result. In other words, if I've got ten
10 possible outcomes, you know, from 100 to 110 and any one
11 of them can arise, that would be 11 I guess, and any one
12 of them has an equal probability of arising, then the
13 expected value of that outcome would be the mid point,
14 and that's what I assumed.

15 BY MS. ANDERL:

16 Q. Dr. Selwyn, the situation you just described,
17 isn't it true that the expected outcome in any given
18 instance wouldn't be the mid point, would rather be
19 above the mid point half the time and below the mid
20 point the other half the time?

21 A. Well, if I'm looking for a point outcome, if
22 I take -- if I have 11 observations and going from 100
23 to 110, 100, 101, 102 and so on, and each of them has a
24 probability of 1/11 of happening, then the expected
25 value of -- in other words, the expected value of that

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1 -- of the outcome of that distribution is 105. If I
2 have -- if I have, you know, 11 marbles in a hat and
3 they are numbered from 100 to 110 and I randomly pull
4 one out and I do that enough times, on average the value
5 that I'm going to pull out is 105.

6 Q. That's the average value, I agree with you,
7 Dr. Selwyn. Isn't it true though that half the time the
8 value you pull out would be lower than the mid point?

9 A. And half the time it would be higher. Well,
10 not half, 5/11 it would be lower, 5/11 it would be
11 higher, and 1/11 it would be at mid point in that
12 example.

13 Q. So the probability of the mid point being the
14 point value is 1/11?

15 A. In that example, yes.

16 Q. Is it your testimony that \$7.05 Billion does
17 not represent the fair market value of the Dex
18 publishing operation when sold to a third party in
19 August of 2002?

20 A. It's my testimony that it appears to be less
21 than the consensus business enterprise value as it
22 existed at that time.

23 Q. But I asked you about fair market value, not
24 business enterprise value.

25 A. Well, again, we have to go back to my

0858

1 discussion with you earlier about what fair market value
2 is, and I have already indicated that one is -- that one
3 can look at transactions as informative as to what fair
4 market value is but not dispositive. So no, I'm not
5 prepared to state on the basis of the one transaction
6 that took place that that was the fair market value of
7 that asset given the constraints associated with that,
8 particularly given the constraints associated with the
9 transaction. There were some very severe constraints.

10 Q. You have said you're not prepared to state
11 that it is the fair market value, are you prepared to
12 state that it is not?

13 A. I'm prepared to state that it is less than
14 the business enterprise value that I believe existed as
15 of that point in time based on the consensus opinions of
16 the financial advisors.

17 Q. Based on your interpretation of the financial
18 advisors' valuations?

19 A. Based on my interpretations as well as what's
20 on the paper.

21 Q. Can you show me in any of the valuation
22 documents that you reviewed where any analysts indicated
23 that they had reached a consensus that the mid point was
24 the business enterprise value?

25 MR. TRAUTMAN: Objection, asked and answered.

0859

1 JUDGE MOSS: Overruled.

2 A. No, I can't show you that, because there was
3 no single number reported as a consensus value.

4 BY MS. ANDERL:

5 Q. Thank you. Dr. Selwyn, I would like to ask
6 you about pages 45 and 46 of your testimony as well as
7 Exhibit LLS-15, which is Exhibit 325C.

8 JUDGE MOSS: It may be the hour, what was the
9 exhibit number?

10 MS. ANDERL: That's fine, 325C.

11 JUDGE MOSS: Thank you.

12 CHAIRWOMAN SHOWALTER: And I have forgotten
13 the page number.

14 JUDGE MOSS: That I can help you, 45.

15 MS. ANDERL: 45 and 46.

16 THE WITNESS: I'm very -- I think it's very
17 fortunate that the attachment numbers and the exhibit
18 numbers are off only by ten, because that arithmetic I
19 can do this time of the afternoon.

20 MS. ANDERL: That helps.

21 A. All right I'm there.

22 BY MS. ANDERL:

23 Q. Dr. Selwyn, we do have some confidential
24 numbers in the record, and I know that you have been
25 cautious in guarding them, so let's try to both be

0860

1 cautious to not blurt one out on the record.

2 In pages 45 and 46 of your testimony as well
3 as on your Exhibit 325C, you have estimated a higher
4 value of the Washington regulatory asset, is that right,
5 higher than the Washington share of the realized sale
6 price?

7 A. That's based -- yes, the estimate's based
8 upon the present value of the imputations and the growth
9 in imputation as using the initial year imputation and
10 then extrapolating and applying the growth rate to that.

11 Q. And your estimate of the Washington share of
12 the value of the Dex properties is contained on page 46,
13 line 1; is that right?

14 A. Yes.

15 Q. Now is it your claim that that amount is the
16 fair market value of the asset?

17 A. No, that is -- that is the value that
18 represents the point of rate payer difference, that
19 is --

20 Q. So it's your calculation --

21 A. May I finish my answer?

22 Q. Oh, all right.

23 A. In other words, to the extent that rate payer
24 -- the rate payers' proceeds of the transaction fall
25 below that number, rate payers are made worse off vis a

0861

1 vis the status quo. And to the extent that the proceeds
2 were in excess of that number, then rate payers, again
3 present value of the proceeds, rate payers would be made
4 better off than under the status quo.

5 Q. Do think rate payers should be made better
6 off in this transaction then they would be under the
7 status quo?

8 A. In a circumstance where the fair market value
9 of the transaction was -- could be shown to be in excess
10 of the amount that would produce this result for rate
11 payers, then rate payers should be made -- should be
12 benefited by that, yes. In this case, I have not
13 suggested that to be the situation, merely to suggest
14 that the rate payer under a different standard would
15 require that this be the amount of the Washington share.

16 Q. So if the asset had been sold for an amount
17 that produced a Washington share of the gain higher than
18 your calculation at page 46, line 1, you would then
19 recommend to not use your calculation but rather use the
20 Washington share of the gain?

21 A. Yes.

22 Q. Now would you calculate or would you
23 characterize your number at page 46, line 1, as
24 significantly higher than the Washington share of the
25 realized sale price?

0862

1 A. It's higher, yes. I'm trying to remember
2 where I have the calculation of the Washington share of
3 the sale price, but it's there someplace.

4 Q. Would you say it's significantly higher?

5 A. Yeah.

6 Q. Now you in your calculation first calculated
7 a Washington specific number, and then you extrapolated
8 to a 14 state number or regionwide number; is that
9 right?

10 A. By taking the Washington number as the
11 percent of the total, yes.

12 Q. And you identify that regionwide number at
13 pages 53 and 54, is that right, specifically the Table 3
14 on page 54?

15 A. Right.

16 Q. Dr. Selwyn, were you involved in the bidding
17 or auction process that took place between April and
18 August of last year in connection with the sale of Dex?

19 A. No.

20 Q. Do you have any firsthand knowledge that
21 there was a buyer in the auction process who submitted a
22 firm bid for Dex in the amounts you set forth on page
23 54?

24 A. I made no such assertion, and I don't know
25 that as a fact, and I suspect that probably was not the

0863

1 case.

2 Q. Do you have any firsthand knowledge that
3 there was a buyer in the auction process who submitted a
4 firm bid for Dex in any amount in excess of \$7.05
5 Billion?

6 A. It's my recollection that there was at least
7 one offer for Dexter that was above the \$2.75 Billion
8 offer for Dexter in the Carlyle bid, but I don't
9 believe, at least not to my knowledge, was there an
10 offer in excess -- in that -- within that -- the time
11 constraint and other constraints associated with the
12 bidding process, I don't believe there was an offer
13 higher than 7.05 for both, although I don't know that as
14 an absolute fact.

15 Q. You don't know that there was?

16 A. I don't know there was. I don't know that
17 there was, I don't -- I'm relying on testimony by
18 witnesses here that suggested that there was not, but I
19 don't know personally whether there was or was not.

20 Q. Let's look at your Exhibit 325, and let me
21 ask you a few questions about your discounted cash flow
22 analysis. This analysis has a number of components, and
23 I would kind of like to ask you about a couple of them.
24 Can you tell me the significance of the terminal value
25 in a discounted cash flow analysis?

0864

1 A. Well --

2 CHAIRWOMAN SHOWALTER: Where are you looking
3 just to get us anchored here?

4 MS. ANDERL: Oh, I'm sorry, Your Honor, sure,
5 Exhibit 325, page 1, the top row underneath the heading.
6 At the far right there is an indication that says 2008
7 terminal value.

8 CHAIRWOMAN SHOWALTER: Thank you.

9 BY MS. ANDERL:

10 Q. So the question to you, Dr. Selwyn, was, can
11 you tell me the significance of the terminal value in a
12 discounted cash flow analysis?

13 A. Right. Terminal value is basically a
14 shorthand method of continuing the cash flow analysis
15 out into an indefinite -- for an indefinite number of
16 years. What one typically assumes is that the, for this
17 purpose, that the business continues forever. And once
18 the projected growth rate, for example, has stabilized,
19 becomes a constant, it's possible to make a calculation
20 of the present value of what is generally thought of as
21 a perpetual annuity.

22 For example, if we know that we're going to
23 receive \$100 a year forever at a discount rate of 10%,
24 the present value of that can be calculated simply by
25 dividing \$100 by .10, which would yield a present value

0865

1 of \$1,000. In other words, if I invested \$100 at a 10%
2 rate of interest indefinitely and did not draw down the
3 capital, I would -- I'm sorry, if I invested \$1,000 at a
4 10% discount rate indefinitely, I would get \$100 a year.
5 So it's simply a method of taking the forever portion of
6 the cash flow and translating it to a single figure.

7 Q. There's also a growth factor that's applied;
8 is that correct?

9 A. Yeah. What one would typically do is take
10 the discount rate, for example, let's suppose we're
11 going to use --

12 Q. Well, Dr. Selwyn, actually I just wanted to
13 confirm that there was a growth factor that had been
14 applied, then I wanted to ask you some other questions
15 about it.

16 A. Yes, there's a growth factor that's applied
17 to adjust the discount rate in making the terminal value
18 calculation.

19 Q. What was the source that you used for the
20 growth factors in this calculation?

21 A. The long-term growth rate is identified as
22 the company's response to ATG 01-005 confidential
23 Attachment C at page 21.

24 Q. That's the long-term growth rate, what about
25 the other growth rates that you used?

0866

1 A. I think those came from the Merrill Lynch
2 memorandum that we were looking at earlier.

3 Q. The Lehman Brothers memorandum?

4 A. I'm sorry, the Lehman Brothers.

5 CHAIRWOMAN SHOWALTER: Dr. Selwyn, you need
6 to try to use the microphone.

7 THE WITNESS: Sorry, I need to look at this.

8 CHAIRWOMAN SHOWALTER: Right, I realize that,
9 but maybe you could look and then raise your head or
10 just get that microphone right down there on the page.

11 BY MS. ANDERL:

12 Q. And so, Dr. Selwyn, confirming that you
13 believe you used the Lehman Brothers memorandum, can I
14 also confirm with you that that was dated in April of
15 2002?

16 A. Yes.

17 Q. Dr. Selwyn, is it correct to say that your
18 proposal captures value for rate payers that is
19 equivalent to a growing never ending imputation?

20 A. Yes.

21 Q. In capturing the future value of imputation
22 forever, Dr. Selwyn, is there any risk factored into
23 your analysis that the imputation will not grow at the
24 rates that you have assumed?

25 A. Well, the risk factor -- let me respond in

0867

1 this way. First, the risk factor is reflected in the
2 discount rate, which, for example, is well above the 20
3 year treasury note rate that Professor Kalt was
4 discussing earlier today, and that captures some of the
5 risk. Also, as one gets out 40, 50, 60, 80, 100 years,
6 the net present value of the individual payments is
7 extremely small at that, for example, at the kind of
8 discount rate that's used here so that the magnitude of
9 the impact of a different growth rate is extremely small
10 in terms of its impact on terminal value. So the
11 combination of the interest rate and the -- just the
12 extremely low present value factor that would be applied
13 to what is admittedly a less certain outcome is, in
14 fact, captured in this analysis.

15 Q. Well, but you have assumed a growth rate for
16 imputation for each year; is that right?

17 A. I have assumed a growth rate for imputation
18 that reflects growth in the business, inflation,
19 population growth, you know, a whole bunch of factors
20 that would impact the nominal growth in revenues.

21 Q. You have assumed a growth rate for imputation
22 for each year; is that right?

23 A. Yes.

24 Q. And is there any risk factored in to the
25 discounted cash flow analysis that the imputation will

0868

1 not grow at the rate that you have assumed?

2 A. Other than as I have described and capturing
3 it in the form of a risk adjusted discount rate, no, but
4 that's where it is captured. If we knew for certain
5 that this imputation was going to exist, then perhaps we
6 should use the treasury rate that Dr. Kalt has
7 suggested. That's not what I have done here.

8 Q. Well, if the Commission orders it, doesn't
9 that increase the certainty that the level of imputation
10 that you have calculated will continue to exist?

11 A. Well, the Commission is going to order an
12 imputation rate based upon a number of factors,
13 including the then extant earnings of the publishing
14 affiliate, whatever those happen to be. I don't believe
15 that the Commission's imputation formula has locked in
16 any particular set of numbers. It's locked in a
17 process.

18 Q. And in --

19 A. And to the extent that if inflation is
20 higher, if inflation is lower, if population changes
21 differently, if based on economic conditions, that
22 number might change.

23 Q. The number could go down, couldn't it?

24 A. Could go down, could go up.

25 Q. You don't assume in your analysis that it

0869

1 goes down though, do you?

2 A. No, I assume that it is a risk adjusted --
3 I'm using a risk adjusted discount rate that reflects
4 the fact that it could be higher or lower. If I knew
5 for a fact that it was going to be exactly that amount,
6 I would have used -- had I, for example, used the 20
7 year treasury note discount rate that Dr. Kalt
8 suggested, then my result would have been significantly
9 higher in terms of present value than the figure that's
10 shown here, and that is why this figure reflects the
11 risk associated with that revenue stream.

12 Q. What rate did you use?

13 A. 10%.

14 Q. And what's the basis for that?

15 A. That was at least -- that was in the range of
16 the discount rates being used by some of the advisors.
17 I don't remember which one that was, but that was -- I
18 mean it was based upon the numbers that they were using.

19 Q. So is it your opinion that the continued
20 imputation ordered forever under your recommendation has
21 the same level of riskiness as the transaction being
22 considered by the advisors?

23 A. Well, to the extent that the imputation is a
24 function of earnings, then I felt that it was reasonable
25 if imputation is going to be linked to earnings and if

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1 the advisors are using a discount rate of that magnitude
2 to capture future earnings, then it's reasonable to use
3 the same discount rate to capture the imputation.

4 Q. Now, Dr. Selwyn, getting back to your
5 ultimate recommendation, you have recommended that the
6 Commission should not approve the sale; is that correct?

7 A. Well, I have recommended that based upon the
8 sale as proposed with the -- remember, my testimony as
9 originally written was premised on 4 1/2 years of
10 continued imputation and no up front bill credit. That
11 certainly -- that proposal was significantly less than
12 the -- than any reasonable calculation of the continued
13 value of the imputation, and on that basis, rate payers
14 are being made decidedly worse off.

15 Q. Now you filed testimony in response to the
16 stipulation.

17 A. Right.

18 Q. Are you withdrawing your recommendation given
19 the stipulation testimony about the Commission approving
20 the sale?

21 A. Well, I'm not withdrawing it. I have
22 expressed concern in my stipulation -- I mean clearly
23 the stipulation gets us a lot closer, but the core
24 problem is still there, that the present value of the
25 continuing imputation is a lot greater than the

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1 stipulation. And in addition, as I have explained in my
2 supplemental testimony, I have serious concerns about
3 the effects of an unfunded revenue credit that in my
4 view may be unsustainable in the absence of the, you
5 know, then ongoing earnings flowing to the company,
6 which is the case now. And so certainly as the
7 settlement is presented, I would similarly retain my
8 recommendation.

9 Now could the settlement be modified in a way
10 that would make it acceptable, certainly. For example,
11 by moving more of the revenue credit into an up front
12 payment which would reduce the risks, the rate payer
13 risks associated with that revenue credit, as
14 Dr. Blackmon has suggested, might create a solution that
15 would be fair to all parties. But as presented in the
16 precise manner in which it's been presented, I don't
17 believe the settlement is fair, and I don't believe it
18 should be accepted, and it doesn't satisfy the
19 Commission's standards.

20 Q. Is it still your primary recommendation,
21 Dr. Selwyn, that the Commission should not approve the
22 sale?

23 A. Well, I mean I think I need to be realistic
24 here. There is certainly a reasonable chance that upon
25 consideration of all the factors the Commission will

0872

1 determine that the sale in some form should be approved.
2 My recommendation is that in the form as presented it
3 should not be approved. Can the Commission make certain
4 adjustments to the proposal that would make it
5 acceptable, for example, as Dr. Blackmon has outlined in
6 his testimony, I certainly would support that. But as
7 to whether it should be approved strictly in the form in
8 which the settlement has been proposed, my
9 recommendation stands. So no, I'm not modifying
10 anything.

11 Q. Okay. So is it your testimony at this time
12 then that the company is not free to sell the publishing
13 business?

14 A. That calls for a legal opinion. If the
15 company requires the Commission's approval to sell the
16 publishing business and the Commission doesn't grant
17 that approval, then presumably the company can't sell
18 it, at least not as the transaction has been presently
19 structured.

20 Q. Would you accept subject to your check,
21 Dr. Selwyn -- well, let me before we do that, you're
22 familiar with the Supreme Court decision from 1997 that
23 addresses the Yellow Pages issue, aren't you?

24 A. Yes.

25 Q. Would you accept subject to your check that

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1 that Supreme Court decision indicates that the record in
2 this case shows that the company has always been free to
3 sell the business for a fair value?

4 MR. TRAUTMAN: Objection, the decision speaks
5 for itself.

6 JUDGE MOSS: I'm going to have to have the
7 question back, I was distracted.

8 MS. ANDERL: I understand, Your Honor. I
9 just asked Dr. Selwyn to agree subject to his check that
10 the Supreme Court decision contained the following
11 sentence:

12 The record shows the company has always
13 been free to sell the business for a
14 fair value.

15 JUDGE MOSS: All right.

16 MS. ANDERL: I wasn't asking him to interpret
17 it.

18 JUDGE MOSS: He doesn't need to really
19 express himself on that. It says what it says. If it's
20 just a foundation, you can ask a question based on what
21 the Supreme Court said.

22 BY MS. ANDERL:

23 Q. In recommending that the Commission not
24 approve the sale, that is the foundation for your
25 recommendation, your opinion that the company is not

0874

1 receiving fair value?

2 A. Yes.

3 Q. You testified earlier you had not been
4 retained to provide a single point estimate of the fair
5 market value for the business; is that right?

6 A. Yes.

7 Q. And you also testified that you could not say
8 that \$7.05 Billion either was or was not fair market
9 value; is that right?

10 A. I said I believed it was less than the fair
11 market value.

12 Q. Dr. Selwyn, isn't it correct that you
13 indicated that it was less than the analysts' estimates
14 of the business enterprise value?

15 A. Well, that too, but I also said it was less
16 than the fair market value when you considered fair
17 market value in the context of an unconstrained
18 transaction.

19 Q. What is the fair market value for the
20 business?

21 A. I do not have -- I have not developed an
22 estimate of fair market value, and I don't offer one.

23 Q. With regard to the testimony you gave a few
24 moments ago about the settlement testimony, and I will
25 have some more questions for you on that later, but I

0875

1 just wanted to follow up on one point, if you were to
2 front load, as it were, the distribution of rate payer
3 benefit, how does that protect the interests of future
4 rate payers, or does it?

5 A. Well --

6 Q. Or even current rate payers into the future?

7 A. Well, there are several ways in which the
8 front loading could be accomplished. The front loading
9 could be accomplished, for example, by taking a credit
10 against rate base, which would then have the effect of
11 reducing --

12 Q. I'm sorry, Dr. Selwyn, I meant to ask you
13 about your recommendation in the context of
14 Dr. Blackmon's testimony, which indicates a higher up
15 front bill credit, and my question was limited to that.

16 A. Well, I did not interpret, and perhaps you
17 need to ask Dr. Blackmon what he exactly meant, but I
18 did not interpret his testimony as necessarily
19 suggesting that the entire amount of the bill credit be
20 paid out as a single payment, and I'm not sure that that
21 is necessarily a good idea anyway, because it doesn't
22 necessarily reflect -- it captures for today's rate
23 payers in effect the Yellow Page imputation that
24 tomorrow's rate payers, who may not be the same people,
25 would otherwise have received.

0876

1 And I understood his recommendation to be in
2 the form of an up front payment, and the up front
3 payment could be used to pay down as a credit against
4 rate base, to pay off some QC debt, or do whatever has
5 to be done in order to reduce on a permanent basis the
6 revenue requirement in a way that is sustainable and
7 protect it from a condition in which a subsequent buyer,
8 for example, of the company would find that it was not
9 able to maintain the revenue credit in order to earn a
10 fair return on its investment. If the -- if the book
11 value of the -- of the company assets or the company's
12 rate base were reduced, then its revenue requirement
13 could be reduced on an indefinite basis that would be
14 much better protected.

15 I think that there are various ways in which
16 this could be accomplished. The concept quite frankly
17 of the bill credit, you know, first came to my attention
18 on Sunday afternoon when I arrived in Olympia, and I
19 haven't really thought through all of the possible ways
20 in which an up front payment could be accomplished, and
21 I think that's something that the Commission would need
22 to address if it decides that an up front payment is
23 appropriate. But in any event, an up front payment can
24 be, in my opinion will eliminate the potential rate
25 payer uncertainty associated with this so-called revenue

0877

1 credit.

2 Q. But only for today's rate payers if it were
3 an up front bill credit?

4 A. If it would, in effect, paid out as a bill
5 credit, yeah, it would only have that effect.

6 Q. And now if it were a credit to rate base,
7 isn't it true that that benefit to rate payers would
8 only be realized if and when a rate case was filed?

9 A. Well, I would envision a situation in which
10 the rate base credit would be flowed through in an
11 immediate rate reduction that would then be sustained
12 over time. So no, I would not -- I would not wait for a
13 rate case to capture the benefit of that credit.

14 Q. So you're recommending a rate making
15 adjustment to be implemented immediately?

16 A. Based upon a bona fide recordable financial
17 transaction that would capture that in effect cash
18 payment to the company, yes.

19 Q. That flows through to rates?

20 A. Yes.

21 Q. Without considering any of the other aspects
22 of the company's expenses or earnings or cost of money
23 or depreciation lives or anything else that one might
24 consider in a rate case?

25 A. Well, the company is always free to file a

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1 rate case, and when it does that, those factors can be
2 considered. But the immediate effect, all else being
3 equal, of a reduction in rate base could be flowed
4 through its rate payers without affecting anything else.

5 JUDGE MOSS: Ms. Anderl, maybe this would be
6 a good moment to pause and consider how we are going to
7 proceed. How much do you anticipate you have from this
8 point forward?

9 MS. ANDERL: I am I think right on schedule,
10 but I probably do have an hour to an hour and a half
11 left of cross-examination.

12 CHAIRWOMAN SHOWALTER: Is that it?

13 JUDGE MOSS: That will be it plus the Bench
14 questions, plus any --

15 MR. HARLOW: If it helps, Your Honor,
16 Ms. Anderl is starting to --

17 JUDGE MOSS: Let's go off the record.

18 (Discussion off the record.)

19 JUDGE MOSS: All right, we have had some off
20 the record discussion concerning our scheduling, and the
21 consensus of both the attorneys and the Bench is that we
22 should stop for today, it's been a long week, and that
23 we will resume on Wednesday with Dr. Selwyn after we
24 have all had the opportunity for some rest over the
25 holiday weekend and so forth. But so my understanding

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1 is that we will be able to start at approximately 10:45,
2 11:00 on next Wednesday. Well, the open meeting should
3 end by about 10:45, and so we should be able to get
4 ourselves in here and get organized and perhaps get
5 started by 11:00, so to the extent that affects people's
6 plans.

7 THE WITNESS: Your Honor, is the expectation
8 based on the estimates that I will be through on
9 Wednesday?

10 JUDGE MOSS: I would certainly think so.
11 Based on the current estimates, I think we're looking at
12 about four hours, and we can certainly get four hours of
13 examination in on Wednesday. And then, you know, if we
14 run -- if this causes us to have a little crunch in time
15 next week, then we can always go a little late on
16 Thursday and make up for it that way, so.

17 THE WITNESS: I guess I would only request if
18 next -- can we go late on Wednesday so I can be done on
19 Wednesday?

20 JUDGE MOSS: I'm confident that we will get
21 you finished.

22 Okay, well, thank you all very much.

23 Wait, there seems to be one more matter.

24 MR. MELNIKOFF: Your Honor, procedurally I
25 wanted to indicate that our participation next week may

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1 be not physically present but on the telephone bridge,
2 and I didn't want to run the risk of dismissal as a
3 party or being in default as a party if that's the case.

4 JUDGE MOSS: I appreciate you letting us
5 know, and there's no risk. You certainly can monitor
6 the proceeding on the phone. As I told you off the
7 record and remind the parties, we don't allow parties to
8 participate by phone except on special permission, but
9 by monitoring, that's fine, it won't prejudice your
10 position in the case.

11 MR. MELNIKOFF: Thank you, Your Honor.

12 JUDGE MOSS: All right, well, with that then,
13 we will be in recess until Wednesday morning at 11:00,
14 thank you all very much.

15 (Hearing adjourned at 5:10 p.m.)

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